



HOULIHAN LOKEY

The REVU

THE REAL ESTATE VALUATION UPDATE

SUMMER 2017 | RETAIL



Market Overview

GENERAL MARKET TRENDS

- **Total investment volume** in U.S. real estate during Q2 2017 was \$88.5 billion, down from \$90.5 billion in Q1 2017 and below the \$105.6 billion in volume that transacted in Q2 2016.¹
- The **top three investors** in U.S. real estate by volume during Q2 2017 were Starwood Capital, HTA REIT, and HNA Group, responsible for \$3.2 billion, \$2.6 billion, and \$2.3 billion in transactions, respectively.¹
- **Multifamily** cap rates hit their lowest level since at least 2000 and sit at 5.45%, indicating that investor interest in the asset class remains strong. **Office** and **retail** cap rates both dropped approximately 30 basis points over the last two quarters. **Industrial** cap rates sit at 6.36%, which is a low point for the current cycle.¹
- There appears to be little room for more **cap rate compression**, as the PwC Q2 2017 Real Estate Investor Survey indicates that investors are “mindful of the potential for additional interest rate increases and market corrections as new supply is delivered.”²
- U.S. GDP grew 2.6 percent in Q2 2017, in line with expectations and above the 1.4% growth for Q1. Analysts expect U.S. GDP growth of 2.2% for full-year 2017, ahead of 2016’s growth of 1.6%.³
- The CMBS “wall of maturities” continues to be a topic of discussion in the industry, with \$108.7 billion of CMBS set to mature during 2017. The ability to refinance the debt will be closely watched.⁴

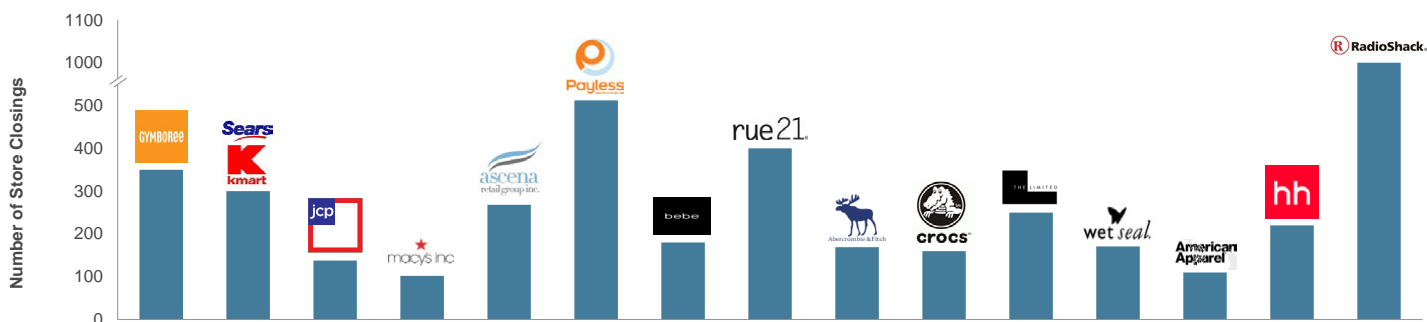
SNAPSHOT BY ASSET CLASS

- **Multifamily** transactions remain strong, with transactions worth \$30.3 billion closing in Q2 2017.¹
- **Retail** investments declined to \$11.1 billion in Q2 2017—the lowest volume in a quarter since Q1 2013.¹
- **Office** transaction volume remained in line with its Q2 2016 performance, with a total of \$31.9 billion in transactions during Q2 2017.¹ **Office** asking rents continue to grow, rising 3.2% in the past 12 months through Q2 2017.⁵
- **Hotel** investment volume of \$6.7 billion was up slightly from Q1 2017 but in line with historical transaction volume from Q2 2016.¹

Average U.S. Cap Rates & Movements (Since Q4 2016)¹

| Asset Class | Average U.S. Cap Rate | Change (Since Q4 2016) |
|-------------|-----------------------|------------------------|
| Multifamily | 5.5% | ↓ 13 bps |
| Retail | 6.2% | ↓ 29 bps |
| Office | 6.3% | ↓ 34 bps |
| Industrial | 6.4% | ↓ 54 bps |

Figure 1: Recently Announced U.S. Retail Store Closings¹⁰



Sources:

1. Real Capital Analytics, Q2 2017.
2. PwC Real Estate Investor Survey, Q2 2017.
3. Bloomberg.
4. Trepp CMBS Research, Wall of Maturities Update: \$9 Billion in CMBS Due in February, February 2017.
5. JLL Office Outlook, Q2 2017.

Sector Focus: Retail

- The rise of **e-commerce** has led to a rapidly changing retail landscape. One common strategy being employed is to close stores in tertiary malls and fortify an urban presence. Consequently, **urban retail real estate** has been bolstered in value, while regional malls have suffered.⁶
- Another consequence is the **repurposing of large format retail** into new uses. Retail real estate owners have creatively reused space vacated by anchor retailers to offer **lifestyle/entertainment** options. Asking rents in 2016 grew in all but eleven U.S. metro markets.⁷
- Additionally, the recent **Amazon-Whole Foods** transaction highlights the rapidly blurring lines between large retail and industrial spaces being driven by innovations in speed and mode of delivery.⁸
- Experts at Cushman and Wakefield expect **Class A malls** to continue to thrive. Over the past five years, top-tier malls have either maintained or increased their rents per square foot. These top-tier malls are projected to maintain this trend and outperform Class B and Class C malls in 2017.⁹

Figure 2: Reasons for Reduced Visits to Physical Stores¹⁰



Case Study

SITUATION

The client is an alternative investment manager with assets in a range of credit-related strategies that invested into a portfolio of retail properties. The investment encompasses approximately 30 retail properties located primarily in major metro areas of the United States, including New York, Los Angeles, and Chicago.

HOULIHAN LOKEY'S SOLUTION

Houlihan Lokey was engaged to express our conclusions regarding the range of fair value of the client's investment in order to assist the client in its determination of the fair value of the investment for financial reporting purposes.

Houlihan Lokey's analysis was informed by a deep understanding of the underlying fundamentals impacting retail properties in the current market environment as well as a comprehensive market review that included discussions with our real estate and retail industry bankers.

Houlihan Lokey estimated the value of the retail property portfolio on both a sum-of-the-parts and a consolidated basis. For the sum-of-the-parts analysis, Houlihan Lokey valued each individual property using the direct capitalization approach. For the consolidated analysis, Houlihan Lokey valued the portfolio by performing a market multiple analysis. Houlihan Lokey applied appropriate risk-adjusted capitalization rates and market multiples based on consideration of observations in the various markets and the property mix (location and type) of the portfolio.

Sources:

6. Deloitte, 2017 Commercial Real Estate Outlook.
7. Wall Street Journal, "Retailer's Call Centers Bring Life to Dead Mall Space."
8. Forbes, "Amazon's Whole Foods Acquisition Goes Beyond Retail."
9. nreionline, "Five Major Trends That Will Shape Retail Real Estate in 2017."
10. Colliers, "Why Online Isn't the End of the Physical Retail Store."

Services Offered by Houlihan Lokey

Portfolio Valuation Services

- Fair Valuation for Financial Reporting
- Structured Product Valuation and Pricing Services
- Derivatives Valuation & Risk Management
- Valuation Governance & Best Practices
- Securitization & Regulatory Compliance
- Fund Manager Valuation
- Fund Recapitalization & Transaction Opinions
- Portfolio Acquisition & Divestiture Services

Real Estate Services

- Real Estate Valuation & Appraisal
- Real Estate Entity Valuation
- Real Estate Due Diligence & Modeling
- Real Estate Debt Valuation
- Fixed Asset Valuation
- Market Analysis
- Fairness & Solvency Opinions
- Purchase Price Allocations
- Portfolio Valuation
- Estate & Gift Tax Valuation
- Dispute Resolution & Financial Expert Opinions
- Property Tax Valuation



Please stay tuned for our next quarterly edition of *The REVU* this fall. To view our previously released spring 2017 edition of *The REVU*, please email one of the contacts listed.

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