



HOULIHAN LOKEY

The REVU

THE REAL ESTATE VALUATION UPDATE

JULY 2018 | CAUTION – CO-WORKING ZONE AHEAD!



General Real Estate Market Overview

TRANSACTION VOLUME AND DETAIL

- **Total transaction volume** in U.S. real estate was \$114.3 billion in the first quarter of 2018. Year-over-year transaction volumes and prices were up 5% and 8.5%, respectively.¹
- The **top three deals** in U.S. real estate by price during Q1 2018 were the \$2.4 billion purchase of Chelsea Market (New York, New York) by Alphabet Inc.; the \$1.5 billion purchase of Times Square Edition (New York, New York) by Maefield Development and Fortress; and the \$700 million purchase of St. John's Terminal (New York, New York) by OMERS and CPP Investment Board.¹
- **Multifamily** transactions increased 25% year over year, with a total transaction volume of \$34.8 billion in Q1 2018.¹ The apartment sector was the largest, most liquid commercial property market in the quarter. Investors have fretted over rising interest rates in Q1 2018, but, below that concern, there is a deeper fear over the specter of inflation. The growth in apartment deal volume and prices in the face of uncertainty over future interest rate trends can be a sign of investment capital seeking out safer assets.
- **Retail** investments declined 31% year over year to \$13.2 billion in the first quarter.¹
- **Office** investment volume fell 12% year over year, as buyers and sellers are still often too far apart on pricing expectations. The RCA CPPI for the office sector grew on a year-to-year basis in Q1 2018, but prices fell relative to Q4 2017. The total transaction volume for Q1 2018 stood at \$27.4 billion. Cap rates for CBD offices in larger markets are compressing to levels approaching those of the six major metros.^{*1}
- **Hotel** investment volume of \$10.9 billion in Q1 2018 was up 63% year over year. There was clearly investor interest in the hotel sector, though the portfolio deals overstate this interest. Two portfolios accounted for half of the portfolio sales volume: a Hyatt Hotels portfolio purchased by Host Hotels for \$1 billion and a portfolio of various brands bought by Junson Capital for \$800 million. Deal volume for the sale of individual hotels grew at a 30% rate year over year in Q1 2018.¹
- **Industrial** investment volume increased 34% year over year with a total transaction volume of \$20.9 billion.¹

TRENDS

Multifamily and **office** cap rates witnessed little movement in Q1 2018. Price growth, however, has continued to grow and actually accelerated into Q1 2018, in line with the growth in deal volume. However, the market is no longer experiencing cap rate compression. In search for yields, many investors hope to pursue opportunities in smaller markets.¹ **Retail** cap rates moved up in six major metros* to 6.6% in Q1, a 10 bps increase since Q4. **Hotel** cap rates tightened to 8.7%.¹

As per the PwC Q1 2018 Real Estate Investor Survey, the **warehouse** sector's strong performance and the positive impacts of the tax bill compressed the cap rate to an average overall cap rate of 4.95%, a tightening of 10 basis points since Q4 2017.²

2018 Scorecard

Average U.S. Cap Rates & Q-o-Q Movement				Q-o-Q Change in Institutional Vacancy Rates			
Multifamily	Retail	Office	Hospitality	Multifamily	Retail	Office	Hospitality
5.6% (unch.)	6.6% (↑ 10 bps)	6.6% (unch.)	8.7% (↓ 10 bps)	unch.	unch.	↑ 10 bps	↓ 20 bps

Source: Real Capital Analytics, Q1 2018

Note: As of Q4 2017, except for Hospitality, which is as of Q3 2017 (latest available for lodging).
Source: Real Capital Analytics and PWC Hospitality Directions 2018

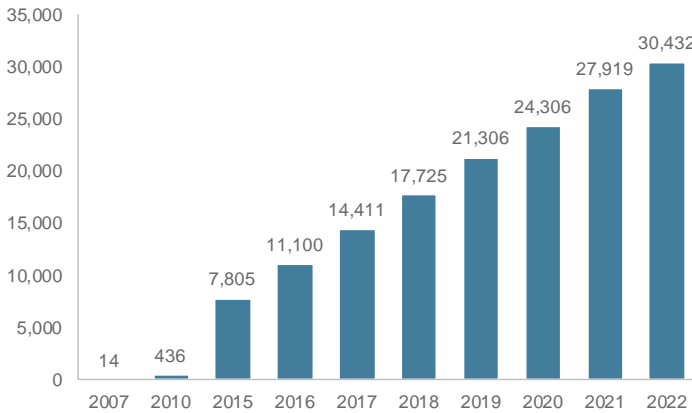
* Six major metros include New York, Boston, Chicago, Los Angeles, San Francisco, and Washington, D.C.

¹ Real Capital Analytics, Capital Trends Report Q1 2018

² PWC Hospitality Directions US: January 2018

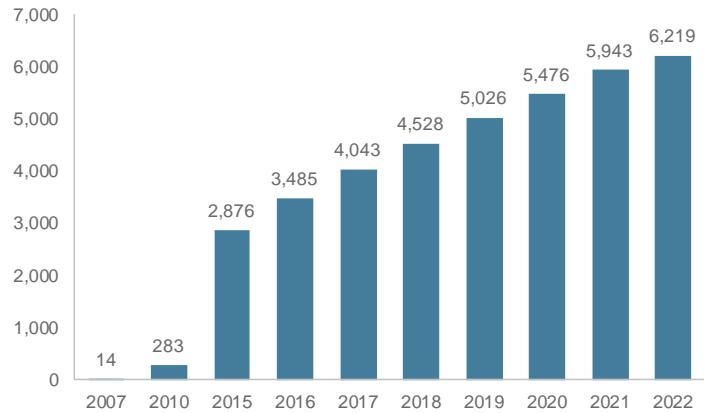
Sector Focus: Co-Sharing Office Space

Global Number of Co-Working Spaces



Source: Emergent Research

U.S. Number of Co-Working Spaces (Includes office co-working spaces, makerspaces, and other shared, collaborative spaces)



Source: Emergent Research

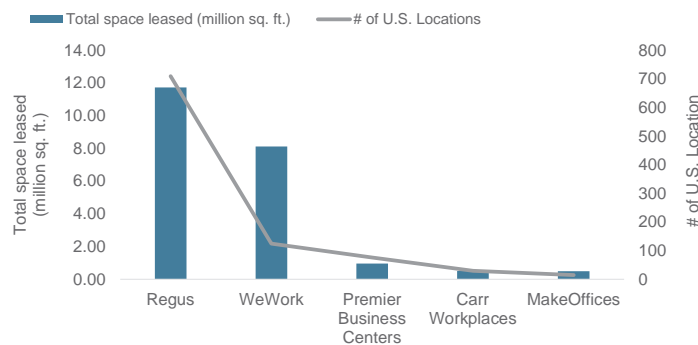
Since 2010, co-working has been growing at a rate of 23% per year. If the co-working sector continues to grow at this rate, it is forecasted that there will be nearly 100 million square feet of co-working spaces in the U.S. by 2020.³

As of 2017, there were approximately 542,000 U.S. co-working members/users in 2017. Small Business Labs forecasts the number of co-working members will increase to 638,000 in 2018 and 754,000 in 2019.⁴

In Q4 2017, the U.S. **flexible space/co-working sector** claimed more than a quarter (29.4%) of the total U.S. office absorption over the past 24 months, approximately 18.1 million square feet.⁵

Co-working spaces represent a small yet growing segment of the office market. A study conducted by the Yardi Matrix of 20 major markets found 1,166 co-working sites with 26.9 million square feet of space, representing 1.2% of office space in those markets.⁶ Starting in 2019, a change in accounting rules has dictated that corporations must treat lease obligations as debt on their balance sheets, which gives incentive to avoid long-term leases and provides further tailwinds to the short-term lease co-working sector.⁶

Size of Major U.S. Operators



Source: Cushman and Wakefield

³ LiquidSpace Flexible Office Report Q4 2017

⁴ S. King, "Study Finds U.S. has 27 Million Square Feet of Coworking Space," Small Business Labs, February 13, 2018, <http://www.smallbizlabs.com/2018/02/study-finds-us-has-27-million-square-feet-of-coworking-space.html>

⁵ JLL, "Coworking's Unstoppable Market Growth," <http://www.us.jll.com/united-states/en-us/research/property/office/coworking-market-growth>

⁶ "Shared Space: Coworking's Rising Star," Yardi Matrix Special Report, February 2018

Not just small businesses are participating in the co-working environment. According to WeWork's 2018 Economic Impact Report, 22% of WeWork's members are Fortune 500 companies.⁷

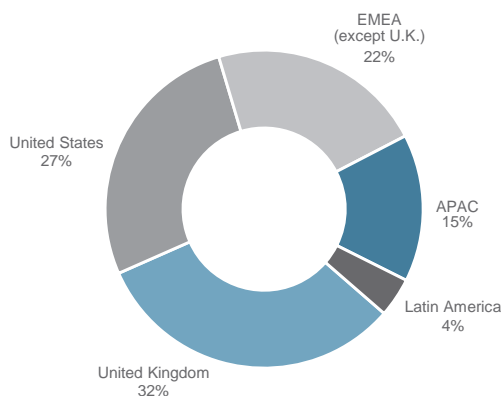
SoftBank Group Corp. is in discussions to invest another giant slug of capital in WeWork Cos. with a deal that would value the shared-office company at \$35 billion to \$40 billion, according to people familiar with the matter. Such an investment would roughly double WeWork's \$20 billion valuation, set last August when SoftBank invested \$4.4 billion in the company.⁸ WeWork also acquired the Lord & Taylor building on Fifth Avenue in Manhattan for \$850 million to use as its headquarters.⁹

WeWork is also developing the project Dock 72, which is expected to be completed this year. Dock 72 will include an enormous co-working space, a luxury spa, and large offices designed and run by WeWork for companies like IBM and Verizon. There will be a juice bar, a traditional bar, a gym with a boxing studio, an outdoor basketball court, and panoramic vistas of Manhattan. There will also be restaurants and potentially even dry cleaning services and a barbershop.¹⁰

IWG, formerly known as Regus, has received takeover approaches from Starwood Capital, TDR Capital, and Lone Star in mid-May 2018. As a result, shares of IWG have increased in price as much as 24%.¹¹

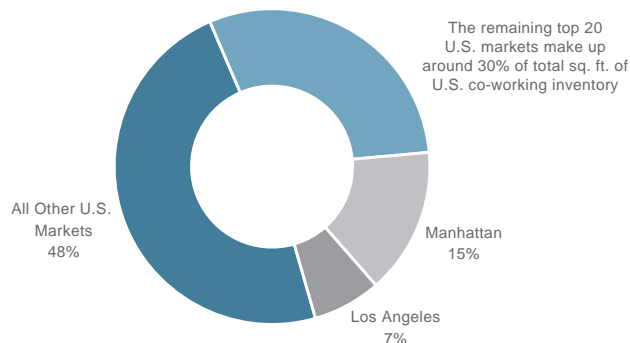
Knotel, a startup firm that is competing with WeWork in the flexible-office-space business and planning a service that will use blockchain to track space listings, just closed a \$70 million funding round valuing the company at roughly \$500 million.¹² The funding round was led by well-known names in the property business, including Newmark Group, Inc., a real-estate services firm that went public late last year, and Moinian Group, a big owner of commercial real estate in the New York region. Other investors included Wolfson Group, Sapir Organization, and Wainbridge Capital.

Total Share of Flexible Workplaces



Source: Cushman & Wakefield

Total Sq. Ft. of U.S. Co-Working Inventory



Source: LiquidSpace

London is by far the largest global location for flexible space options, followed by New York City.¹³ Across Central London alone, flexible workplace providers have taken over 21% of office space in 2017, while competition in regional cities is intensifying.

In early April, WeWork acquired Naked Hub, a primary competitor in China. The transaction was reported to be \$400 million in equity.¹⁴

AFFORDABILITY OF CO-WORKING SPACES VS. LEASING

Co-working spaces are much more affordable in the short term, with the cost in New York City starting as low as \$150 per month. Compare that to the cost of building out your own office space. JLL reviewed data from 2,800 projects across the U.S. and Canada in 2017. The study showed that the office fit-out (cost of designing, constructing, and furnishing a work space) ranged between \$120.18 and \$216.07 per square foot. While these costs can be negotiated as part of a lease, they are incorporated in your co-working rental.¹⁵

7 WeWork Team, "2018 WeWork Economic Impact Report," May 8, 2018

8 Eliot Brown, "WeWork in Talks with SoftBank to Double Valuation to as Much as \$50 Billion," Wall Street Journal, June 13, 2018, <https://www.wsj.com/articles/wework-in-talks-with-softbank-to-double-valuation-to-as-much-as-50-billion-1528923090>

9 Michael J. de la Merced and Michael Corkery, "Lord & Taylor Building, Icon of New York Retail, Will Become WeWork Headquarters," The New York Times, October 24, 2017, <https://www.nytimes.com/2017/10/24/business/lord-taylor-wework.html>

10 David Gelles, "The WeWork Manifesto: First, Office Space. Next, the World," The New York Times, February 17, 2018, <https://www.nytimes.com/2018/02/17/business/the-wework-manifesto-first-office-space-next-the-world.html>

11 Ben Martin, "IWG Shares Jump on Prospect of Three-Way Bidding War," Reuters, May 14, 2018, <https://www.reuters.com/article/us-iwg-m-a-shares/iwgshares-jump-on-prospect-of-three-way-bidding-war-idUSKCN11F123>

12 Peter Grant, "WeWork Rival Knotel Builds Its War Chest, Makes a Bet on Blockchain," Wall Street Journal, April 10, 2018, <https://www.wsj.com/articles/wework-rival-knotel-builds-its-war-chest-makes-a-bet-on-blockchain-1523365200>

13 JLL Flexible Spaces 2017 Report, "Bracing for the Flexible Space Revolution," 2017, <http://www.jll.com/Documents/research/pdf/Flexible-Space-2017.pdf>

14 James T. Areddy, "Office Space: WeWork to Acquire Chinese Rival Naked Hub," The Wall Street Journal, April 12, 2018, <https://www.wsj.com/articles/office-space-wework-to-acquire-chinese-rival-naked-hub-1523521429>

15 Greetly, "Should Your Company Rent Coworking Space or Your Own Office?," Greetly, March 8, 2018, <https://www.greetly.com/blog/should-your-company-rent-coworking-space-or-lease-your-own-office>

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- Valuation Governance & Best Practices
- Securitization & Regulatory Compliance
- Fund Manager Valuation
- Fund Recapitalization & Transaction Opinions
- Portfolio Acquisition & Divestiture Services

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- 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
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