



HOULIHAN LOKEY

The REVU

GENERAL REAL ESTATE MARKET OVERVIEW

DECEMBER 2018 | IS IT FINALLY TIME TO LOUNGE YET?



General Real Estate Market Overview

TRANSACTION VOLUME AND DETAIL

- **Total transaction volume** in U.S. real estate in Q3 2018 was \$152.7 billion, an increase of 17.0% year over year. The third quarter of 2018 saw the most entity level deals than ever before with sales totaling \$29.8 billion.¹
- The **top deals** in U.S. real estate over the third quarter were Brookfield's purchase of 666 Fifth (Condo Leasehold); Disney's purchase of 4 Hudson Square; Boston Property and CPP Investment Board's purchase of Santa Monica Business Park; and Blackstone's purchase of JW Marriot in San Antonio.¹
- **Multifamily** transaction volume totaled \$48.3 billion in Q3 2018. Deal volume was up 14.0% year over year, driven by student housing. The third quarter had historically high levels of student housing transactions constituting 17.0% of total deal activity in the third quarter compared to the annual average of 4.0% since 2005. Student housing transactions constitute approximately 4.0% of multifamily transaction volume.²
- **Retail** transaction volume totaled \$28.4 billion in Q3 2018. The sector saw a 291.0% year-over-year volume change driven primarily by Brookfield's acquisition of GGP.³
- **Office** transaction volume grew 15.0% year over year in Q3 2018, driven in part by a 7.9% year-over-year increase in price. The growth is primarily due to a turnaround in CBD office sales. The recent growth in deal volume for the office sector is notable in that it is driven by the sale of individual assets rather than portfolio or entity-level transactions.⁴
- **Hotel** transaction volume in Q3 2018 was up 2% year over year. The pace of mega deals was down sharply in Q3 2018 after strong growth in Q1 and Q2 of 2018. With modest growth in deal volume, prices have increased by 6.5% year over year in Q3 2018.⁵
- **Industrial** transaction volume in Q3 2018 saw a decrease of 1.0% year over year, however, total transaction volume for the year stood at \$23.7 billion. The sector is on target to hit a record level of activity for the year, primarily driven by Prologis' acquisition of DCT in August. Single asset sale pricing increased to record levels, growing 9.0% year over year in Q3 2018.⁶

TRENDS

- **Multifamily** and **office** cap rates witnessed little or no movement in Q3 2018. Price growth for multifamily, however, has diverged for mid- and high-rise assets and garden apartments. Prices for mid- and high-rise assets are down 40 basis points in Q3 2018, while prices for garden apartments are up by 260 basis points. Office prices have continued to grow in Q3 2018, in line with the growth in deal volume. However, the market is no longer experiencing cap rate compression. **Retail** and **Hotel** cap rates have remained unchanged.⁶

Q3 2018 Scorecard

Average U.S. Cap Rates & Y-o-Y Movement				Q-o-Q Change in Institutional Vacancy Rates			
Multifamily	Retail	Office	Hospitality	Multifamily	Retail	Office	Hospitality
5.5% (↓ 10 bps)	6.5% (unch.)	6.6% (unch.)	8.7% (unch.)	↓ 20 bps	unch.	unch.	↓ 30 bps

Source: Real Capital Analytics

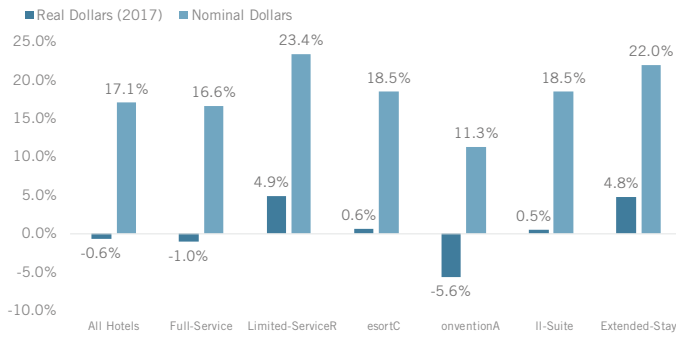
Note: As of Q2 2018 (latest in RCA), except for hospitality, which is as of August 2018 (latest available for lodging)

Source: Real Capital Analytics and PWC Hospitality Directions August 2018

1 Real Capital Analytics, Capital Trends Report Q3 2018
 2 Real Capital Analytics, Multifamily Trends Report Q3 2018
 3 Real Capital Analytics, Retail Trends Report Q3 2018
 4 Real Capital Analytics, Office Trends Report Q3 2018
 5 Real Capital Analytics, Hotel Trends Report Q3 2018
 6 Real Capital Analytics, Industrial Trends Report Q3 2018

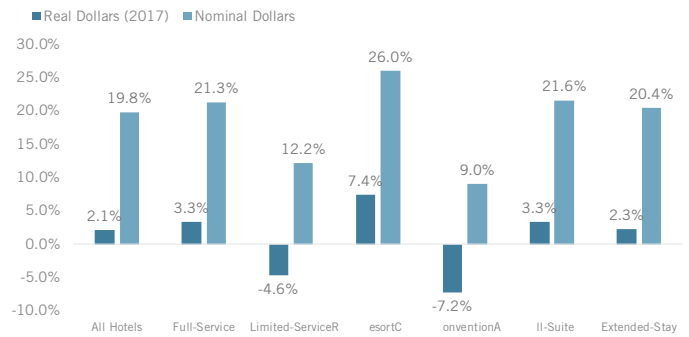
SECTOR FOCUS: HOSPITALITY

U.S. Hotels – Total Operating Revenue Changes from 2007 to 2017: Real vs. Nominal Dollars



Source: CBRE Hotels' Americas Research, Trends in the Hotel Industry, Q3 2018

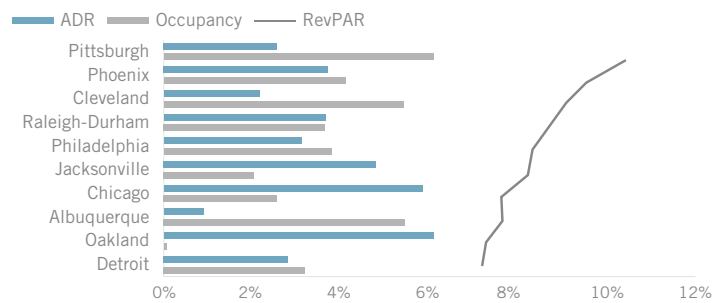
U.S. Hotels – Gross Operating Profits Changes from 2007 to 2017: Real vs. Nominal Dollars



Source: CBRE Hotels' Americas Research, Trends in the Hotel Industry, Q3 2018

- Hotel deal volume grew in Q3 2018 but at a slower pace than earlier this year. The sales of mega deals was down sharply in the third quarter after experiencing explosive growth in the first and second quarter. The sale of individual assets were up 10% year over year in Q3 2018.
- Hotel cap rates in the 6 major metros* averaged 7.4% in Q3 2018. The figure is down from a high of 7.9% seen earlier in the cycle. Cap rates have continued up for the smallest markets in the U.S. with cap rates in tertiary markets averaging 9.1% in Q3 2018.⁷
- In terms of real revenue growth, limited-service (growth of 4.9%), resort (growth of 0.6%), all-suite (growth of 0.5%), and extended-stay (growth of 4.8%) hotels were the four property-types that were able to achieve real growth over the 10-year period. Full-service (decline of -1.0%) and convention (decline of -5.6%) properties have yet to return to the real revenue dollars achieved in 2007.⁸
- According to the June 2018 edition of Hotel Horizons®, CBRE Hotels' Americas Research is projecting that a 2.6% increase in RevPAR will lead to a 2.5% gain in total hotel revenues during 2019. Concurrently, operating expenses are forecast to rise by 1.9%, leading to an improvement in profits of roughly 3.5%.¹⁰
- Of the top 10 ADR growth markets, only San Francisco and San Jose-Santa Cruz had RevPAR gains that did not exceed ADR growth. Three of the top-four ADR growth markets were in the Bay Area, reflecting the continued positive impact of the tech industry on lodging demand.⁹

Top-10 RevPAR Growth Markets: ADR & Occupancy Change



Source: CBRE Hotels' Americas Research, STR, Q3 2018

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

⁷ Real Capital Analytics, Hotel Trends Report Q3 2018

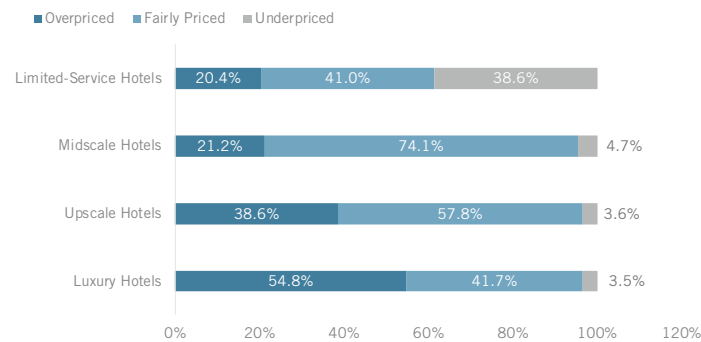
⁸ CBRE: Ten Years Later: Has the U.S. lodging industry really recovered? by R. Mandelbaum and K. Rama

⁹ CBRE: Q3 2018 US Hotel Figures

SECTOR FOCUS: HOSPITALITY (continued)

- Equity yield rates were notably lower for full-service and luxury hotels, averaging 16.8% for the year-to-date 2018 period, driven largely by a lower number of total transactions of this asset type, coupled with an increase in certain full-service sales of iconic assets in highly sought-after coastal markets with high barriers to entry.¹⁰
- Equity yield rates for select-service and upscale, limited-service hotels averaged 18.8% for the year-to-date period ending September 2018, while the average equity rate for lower-tier limited-service hotels was 20.1% for the noted 2018 period.¹⁰

Opinion of Current Hotel Pricing



Source: Emerging Trends in Real Estate 2019 survey. Based on U.S. respondents only.

- Hurricanes Michael and Florence have passed, but the extent of their destruction is now coming into clear focus. Hotels and beachfront resorts in coastal areas are particularly vulnerable, and business interruption can be long-lasting. According to David Jefferys of Conde Nast Traveler, six notable hotels remained unopened or partially open a year after Maria's September 20, 2017 landfall in Puerto Rico.¹¹ As of October 3, a total of 65 hotels accounting for 4,422 rooms in North Carolina were confirmed to be closed due to storm-related damage.¹²
- Despite increased regulations, Airbnb has passed a milestone with 400 million guest arrivals to date. The milestone was reached on August 26, the same month that Airbnb recorded its largest single night in history with 3.5 million guest arrivals taking place on August 11, 2018.¹³

CASE STUDY

Houlihan Lokey was engaged as the financial advisor to provide transaction support and valuation advice to a private real estate company (the "Sponsor") underwriting an investment in a destination hotel resort in the southern United States (the "Resort"). The Resort was operationally complex as it was subject to a ground lease with a federally sponsored entity and comprised of a hotel, waterpark, marina, RV Park, and several food and beverage outlets. In addition, various components of the Resort had just recently been or would be converted to a major national brand. In connection with this investment, the Resort was being acquired by a third-party real estate developer (the "Developer"). Houlihan Lokey's analysis included an assessment of the property on an as-is basis, as well as considering the potential redevelopment of the Resort and exit strategies. The project included an in-depth analysis of the various operating components of the property, focused market research relevant to each operating segment, the development of financial projections and an assessment of the ability of the developer to execute on the turnaround plan. Furthermore, Houlihan Lokey developed a working underwriting model for the Sponsor. Houlihan Lokey visited the property as well as other properties developed by the Developer and held in-depth discussions with current property management, the Sponsor, the Developer and other market participants when developing the analysis.

This situation highlights Houlihan Lokey's unique capability to execute on complex real estate situations with a focus on operationally complex assets. Our team of banking and valuation professionals coordinated to provide timely and highly relevant advice to the Sponsor.

¹⁰ Industry Update: Equity Yield Rates on the Decline: By R. G. Clough and J. Allen, at HVS, Oct, 2018

¹¹ Disaster-related Hotel Business Loss Recovery – Unique Challenges by Mark Earle, October 2018

¹² STR: North Carolina sees 65 hotel closings, performance lift following Hurricane Florence, October 2018

¹³ Hotel Business: AirBnb reaches milestone with growth, September, 2018

Valuation Services Offered by Houlihan Lokey

Portfolio Valuation Services

- Fair Valuation for Financial Reporting
- Structured Product Valuation & 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 Valuation 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



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Houlihan Lokey holds an indirect minority stake in Leonardo & Co. S.p.A., an investment bank with an office in Milan.

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