Lodging Investment Outlook

United States | Q4 2016

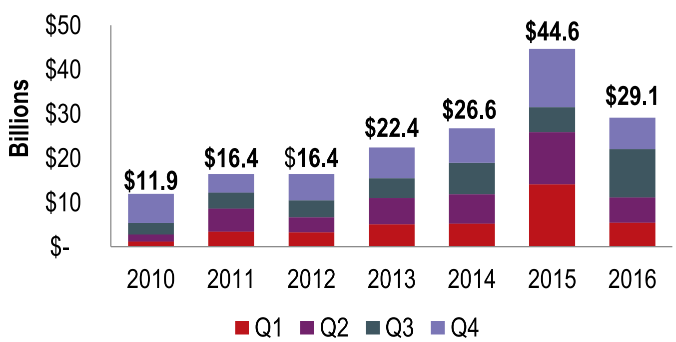
LODGING

U.S. hotel transactions represented nearly 50 percent of all sales globally in 2016 despite the softening of lodging market fundamentals, looming supply and political uncertainty

U.S. Lodging property market		U.S. Lodging investment	
0.1%	3.2%	$29.1	-34.8%
Year-to-date occupancy growth	Year-to-date RevPAR growth	Investment sales (FY, billions of $US)	FY investment sales growth (%)
1.6%	3.1%	7.6%	50
Year-to-date supply growth	Year-to-date ADR growth	Average actual going-in cap rate (%)	12-month change in cap rate (bps)

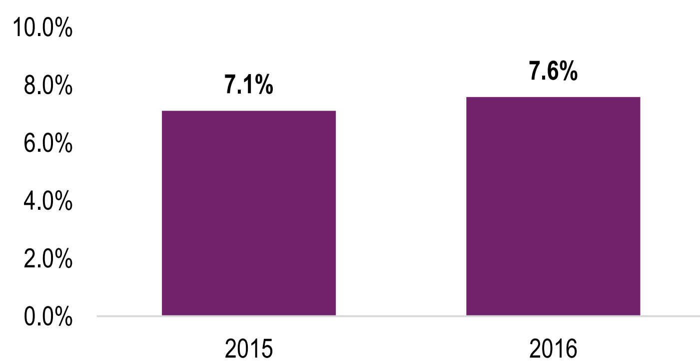
- **U.S. hotels posted RevPAR growth of 3.2 percent in 2016,** representing half of the growth the market observed in 2015. Growth varied notably among the top-25 U.S. markets, with five markets experiencing a decline. That said, the most recent trends are suggesting a potential RevPAR bounce, with investors' expectations for 2017 more positive than three months ago.
- **Supply growth has steadily increased** and grew 1.6 percent in 2016. The supply outlook for each of the top-25 markets differs significantly, with New York, Seattle and Denver leading the list. The number of hotel rooms under construction as a percent of existing room supply ranges from 10.3 percent to 13.3 percent in the aforementioned markets.
- **The United States accounted for nearly 50 percent of transaction volume globally.** Despite this heavy weighting toward investment in the United States, U.S. hotel transactions volume decreased 34.8 percent in 2016 relative to the prior year's extraordinary levels.
- **2017 is anticipated to be the year of increased clout of the domestic buyer.** In 2016, the Dow Jones U.S. Hotel & Lodging REIT Index rallied 44 percent, an impressive increase that paves the way for more acquisitions by REITs. Private equity funds are also expected to become more active players in the U.S. lodging market throughout 2017. Having raised a significant amount of new capital last year, many of these investors plan to get back in the game after not being active buyers in 2016.
- **More M&A activity is anticipated in the hotel industry at the brand and operator level.** In 2016, the lodging industry, similar to other major industries, observed an increased level of consolidation, driven by ambitious growth goals, cost efficiencies and individual firm strategies. Notable transactions included Marriott International's purchase of Starwood Hotels & Resorts Worldwide, Anbang Insurance Group's acquisition of Strategic Hotels & Resorts and HNA Tourism Group Co. Ltd's purchase of Carlson Hotels. This trend is expected to continue in 2017, with a recent example being Hyatt Hotels Corporation's acquisition of the Miraval Group.
- **Cap rates increased approximately 50 basis points in 2016.** Market transactions over the year remained solid, notwithstanding investors pricing in additional risk, which resulted in hotels trading at cap rates 50 bps higher relative to the 2015 cyclical lows.

U.S. hotel transactions volume



Source: JLL Research

U.S. hotel transaction volume



Source: JLL
Note: Pertains to U.S. single-asset hotel transactions, logged based on closing date. Excludes portfolio sales. Excludes transactions under $10M or those with a price per room of under $75K. Analysis pertains to approximately 500 transactions for which cap rate data is known.

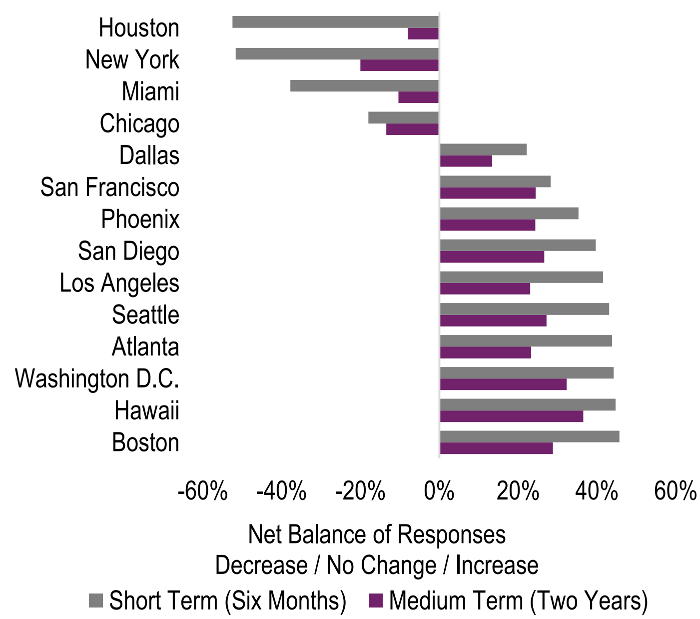
TOP 5 LODGING THEMES

1 Hotel occupancy reaches a new record of 65.5 percent

Hotel occupancy rate in the United States in 2016 reached a new record of 65.5 percent, despite increases in supply and the impact of home sharing and alternative accommodations, suggesting how robust the market remains. In 2017, the additions to supply are projected to place downward pressure on occupancy and, as such, the entirety of RevPAR growth will be driven by ADR growth near the 3.0 percent mark. Growth in corporate transient demand, which was relatively stagnant in 2016, is expected to see an uptick in 2017 given improving corporate profits and economic benefits expected from fiscal stimulus and less regulation on Capitol Hill following President Trump's inauguration. As a result, RevPAR growth in 2017 is expected to be consistent with 2016 growth and range from 2.0 to 3.0 percent.

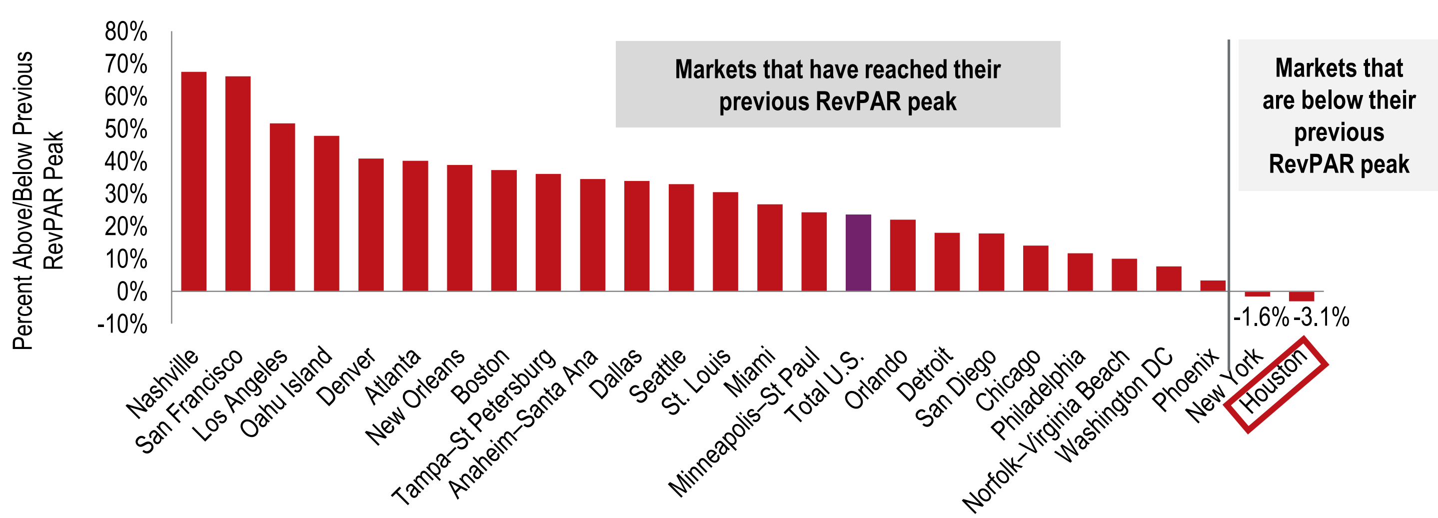
On a more granular level, market participants have a positive bias toward Boston, Washington, D.C. Atlanta, Nashville and smaller markets on the West Coast. The aforementioned markets have demonstrated above-average growth or exhibited insulation from cyclical downswings and are expected to experience strong economic fundamentals in 2017.

U.S. Investors' Hotel Operating Performance Expectations



Source: JLL
Note: net balance represents the proportion of respondents who expect hotel operating performance to increase, minus the proportion of respondents who expect performance to decrease during the given time frames

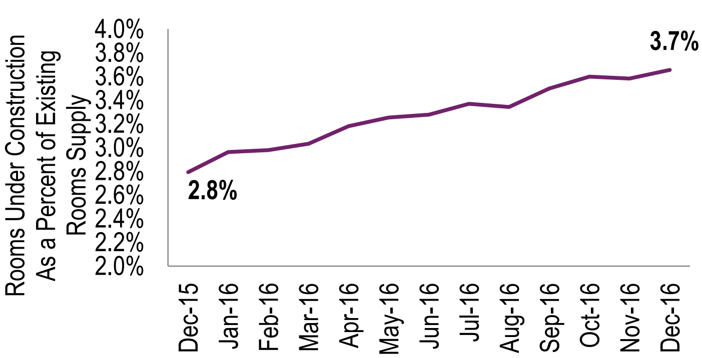
RevPAR performance since previous peak



Source: STR, JLL
Note: current cycle data pertains to full-year 2016 figures

2 Additions to supply continued to grow in 2016; 2017 is anticipated to follow a similar trend

U.S. Hotel Rooms Under Construction



Source: STR, JLL

The number of hotel rooms under construction as a percent of existing supply increased to 3.7 percent in 2016 from 2.8 percent a year ago. Overall supply in the United States increased by 1.6 percent in 2016, under the long-term national average. For 2017, given the current level of hotel rooms under construction, we anticipate additions to supply to grow on par with 2016 and for supply to observe up to a 2.0 percent increase.

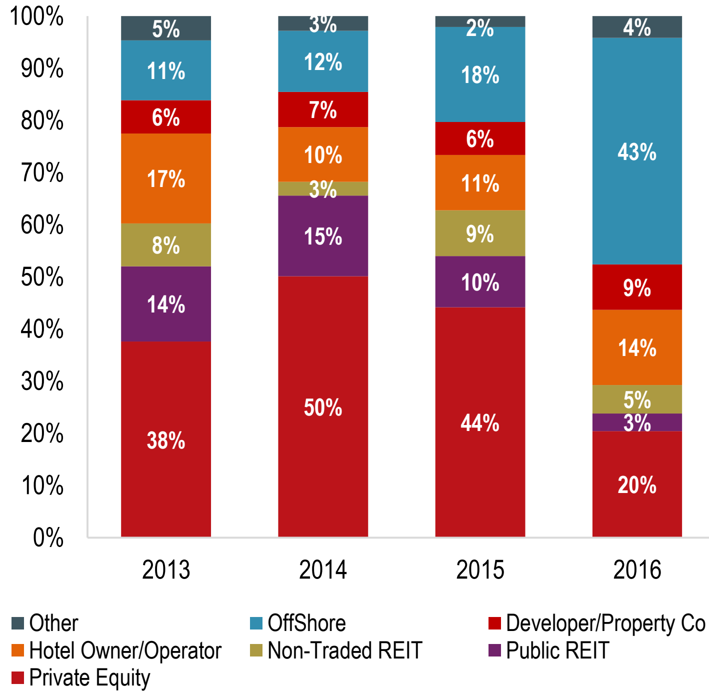
Over 70.0 percent of the hotel rooms under construction are select-service hotels. New York continues to lead the nation in number of hotel rooms under construction, with hotel rooms under construction representing 13.3 percent of the existing rooms supply. Pending new supply in 2016 accelerated in other markets as well, namely Denver and Seattle. Seattle hotel rooms under construction increased from 5.3 percent of rooms supply a year ago to 12.0 percent currently, partly due to the 1,260-key Hyatt Regency Seattle breaking ground. There appears to be a perception that Miami may become oversupplied, but the reality is that Miami is sixth on the list of hotels under construction as a percentage of current inventory at 6.6 percent.

3 2017 transaction volumes are expected to remain on par with the prior year's more normalized levels

Transaction activity in 2016 totaled $29.1 billion, representing a 34.8 percent decrease relative to the prior year's extraordinary level but above the level posted in 2014. Of the $29.1 billion in transactions:

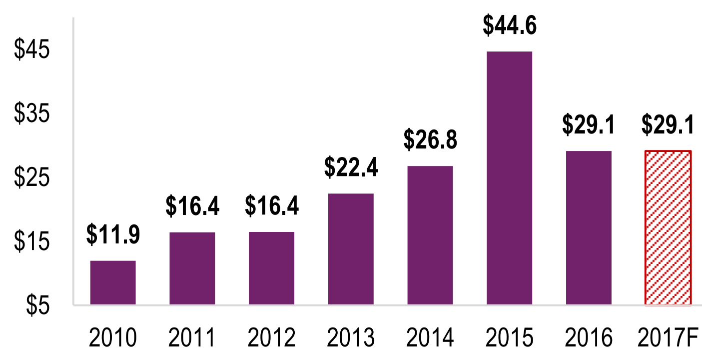
- 70.0 percent were driven by the sale of full-service hotel assets.
- 60.0 percent or $17.3 billion represented single assets, while the remaining 40.0 percent was composed of portfolio sales.
- Purchases by offshore groups accounted for 43.0 percent of total transactions. In 2017, this proportion of international liquidity is anticipated to decrease as domestic buyers become more active. Inbound capital is likely to originate from China—albeit at a more subdued level than 2016 given governmental restrictions—the Middle East and Europe. Europe is expected to increase its outbound capital flows as its institutional investors target high-profile assets. Having deployed just over $1.0 billion in hotel transactions in 2016, Europe is expected to ramp up its outbound capital, and U.S. hotel assets will continue to be a focus for European investors.

U.S. hotel buyer composition



Source: JLL Research

U.S. hotel transaction volume

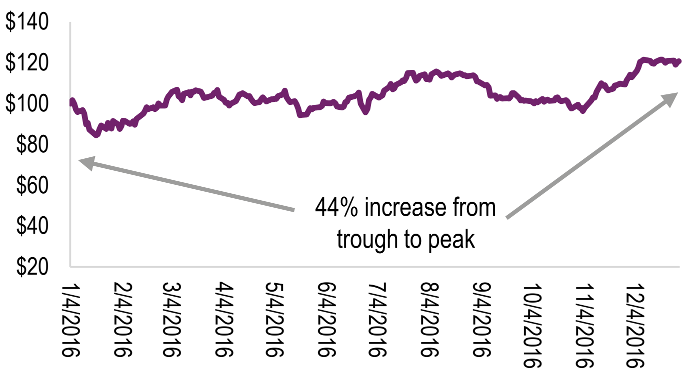


Source: JLL

Our expectation for total U.S. hotel real estate transactions in 2017 is approximately $29.0 billion, mirroring the level recorded in 2016 (which is a significant increase in activity if Anbang's acquisition of Strategic Hotels & Resorts is excluded from 2016). This volume is supported by:

- Greater activity from public REITs, who acquired $4.0 billion worth of hotels per year from 2011 to 2015. The buyer group's contribution should be above the anemic levels observed in 2016 as share prices continue to rise.
- Private equity funds reaching the end of their hold period will sell assets out of legacy funds.
- PE funds have also raised significant capital (tens of billions) and will be seeking to deploy that capital.
- Debt capital markets being open, a market force less prevalent during the first quarter of 2016.

Dow Jones U.S. hotel lodging index share price —2016



Source: WSJ, JLL

4 More mergers and acquisitions on deck

30%

Share of branded full-service hotel rooms involved in brand M&A since 2014

Note: Pertains to hotels positioned in the full-service and luxury categories of companies acquired globally; for part stake purchases, room counts were netted down to proportion that transacted.
Source: JLL

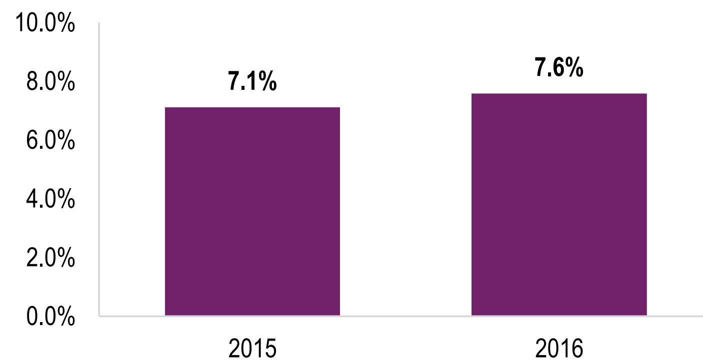
Hotel companies made headlines in 2016 announcing purchases of other parent companies, such as Marriott International's acquisition of Starwood Hotels & Resorts and HNA Tourism Group Co. Ltd's purchase of Carlson Hotels. The full-service brands that changed ownership at the parent company level represent approximately 30 percent of all full-service branded rooms globally. This shows just how prevalent ownership changes have been, and little slowdown is in sight, particularly at the brand and operator level. In January 2017, Hyatt Hotels Corporation announced the acquisition of wellness resorts and spas, the Miraval Group.

5 Cap rates mark moderate increases

According to JLL's proprietary U.S. hotel transactions database, cap rates have followed an upward trend over the past two years and are expected to continue seeing moderate upward pressure in 2017. These market factors could motivate current hotel owners to sell their assets as they look to secure a more desirable cap rate than what is projected for later in the year.

Current cap rate levels reflect various dynamics in the market such as an overall less liquid transactions environment, further increases to the federal funds rate over the next year and more sluggish growth in hotel profits. Cap rates in 2017 are expected to increase an additional 25 to 30 basis points, as we believe the market has already factored in expected interest rate increases on going-in yields.

Actual going-in cap rate 2015 – 2016



Source: JLL
Note: Pertains to U.S. single-asset hotel transactions, logged based on closing date. Excludes portfolio sales. Excludes transactions under $10M or those with a price per room of under $75K. Analysis pertains to approximately 500 transactions for which cap rate data is known.

Notable hotel transactions, Q4 2016					
Transaction	Buyer	Market	Price ($)	Size (keys)	Price ($ per key)
RLJ New York Hotel Portfolio	HX Decker Capital Management LLC	New York	$286,000,000	578	$495,000
Ritz-Carlton San Francisco	WP Carey & Co., Inc.	San Francisco	$280,000,000	336	$833,000
Affinia Hotel New York	Highgate Holdings	New York	$217,500,000	610	$357,000
Courtyard New York World Trade Center	Union Investment Real Estate GmbH	New York	$206,000,000	317	$650,000
Sheraton Hotel Fisherman`s Wharf	ACRON AG	San Francisco	$200,000,000	529	$378,000
Outrigger Reef Waikiki Beach Resort	KSL Capital Partners, LLC	Honolulu - Oahu	$184,948,111	635	$291,000
Ritz-Carlton Kapalua	Ares Management, LLC	Lahaina - Maui	$173,000,000	463	$374,000
Hyatt Regency Pier 66	Tavistock Group	Fort Lauderdale	$163,300,000	384	$425,000
StepStone New York Hotel Portfolio	StepStone Hospitality	New York	$129,900,000	305	$426,000
OHANA Waikiki East	KSL Capital Partners, LLC	Honolulu - Oahu	$128,797,980	441	$292,000
Four Seasons Resort Vail	Extell Development Company	Vail	$121,000,000	133	$910,000
Xenia Hotels Portfolio	Magna Hospitality Group	National	$119,000,000	683	$174,000
Rockbridge Two-Property Portfolio	Starwood Capital Group	Southeast	$116,000,000	527	$220,000
Conrad Fort Lauderdale	Heafey Group	Fort Lauderdale	$100,000,000	298	$336,000

**Note: for part stake sales; price per key represents full implied value*
Source: JLL Research

For more information, please contact:

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