Mid-Year Market View

The State of the Lodging Industry

July 2017

Industry in consensus — lodging market is stable

Steady On

At the conclusion of NYU's International Hospitality Industry Investment Conference, market participants left with a shared sense of cautious optimism and are in consensus that the industry's performance is stable. This is largely attributable to:

- National demand growth continuing to outpace supply
- While GDP growth remains muted, should legislation relating to tax reform and infrastructure spending pass during 2017, the likelihood for accelerating GDP (and with it lodging demand) increases significantly
- Prognosticators elevating their RevPAR growth estimates to range from 2.5% to 3.0% for year-end 2017 RevPAR
- The number of submarkets with positive RevPAR percentage change increasing from 74% to 78% for YTD April 2017 relative to the same period in the year prior
- The number of major U.S. markets with 2.0% supply growth decreasing year-over-year
- Rooms under construction remaining below prior peak levels

Further Upside?

There are several factors that point to the potential of an extended hotel cycle, resulting in an increase in hotel transactions this year.

- Low unemployment and strong stock market performance, combined with the potential for tax reform and infrastructure spending, suggest the U.S. is poised for more robust economic growth. This coupled with an increasing number of terrorist incidents in Europe and political instability around the globe, enhance North America's profile as a safe haven for investment
- The lodging industry is aggressively and creatively competing with alternative accommodations
- Healthy levels of capital raised position Private Equity as the most active hotel investor
- Capital is flowing at an increasing pace in to Public REITs, signaling that investors believe that the industry is poised for a comeback. As a result, REITs accounted for 16% of total volume as of YTD May 2017 as compared to 6% for the same period in 2016
- Foreign investment remains strong and diverse
- Debt markets are open and lenders are becoming increasingly more aggressive

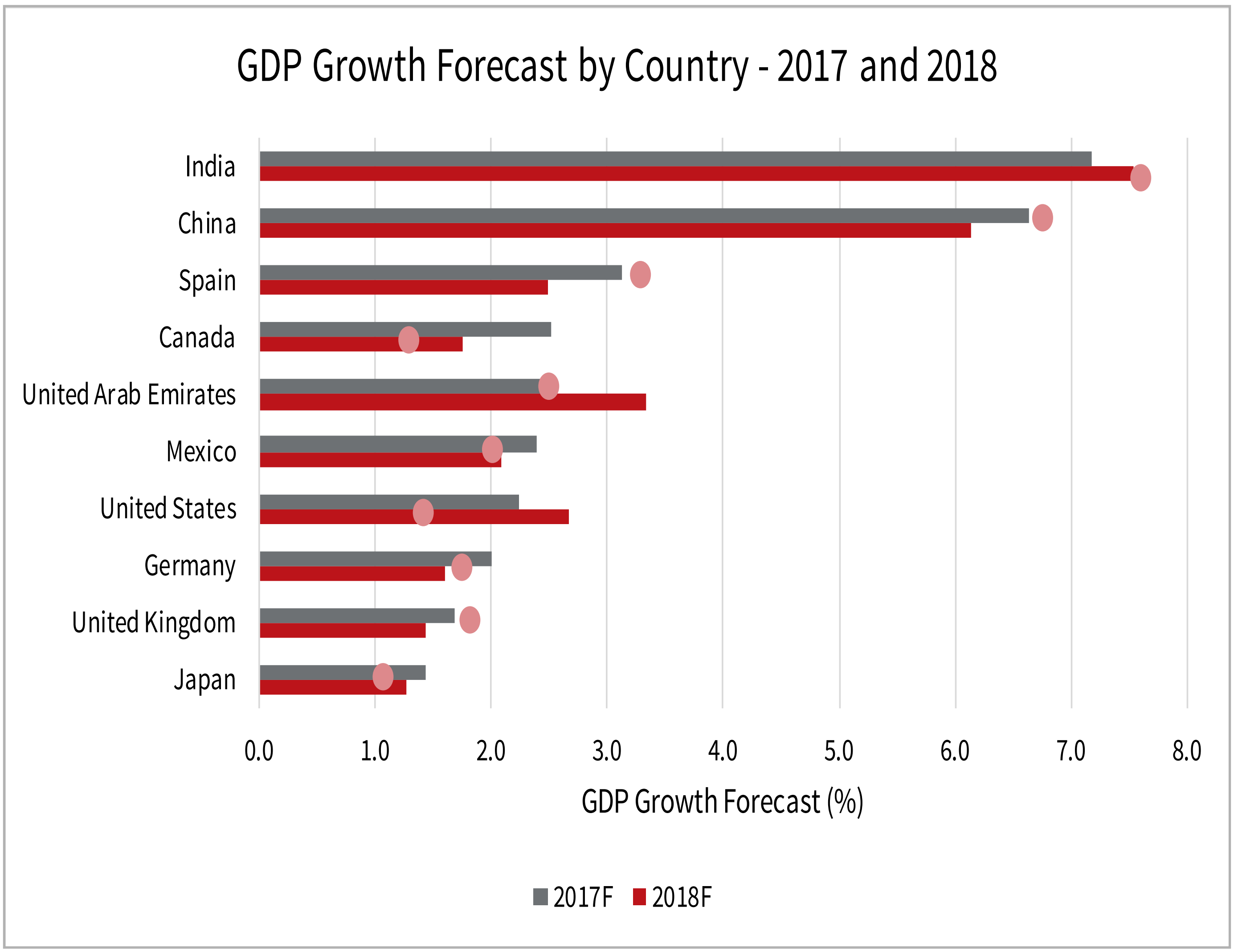
The analysis that follows examines the elements that support our thesis for the potential of an extended hotel cycle and further upside in transaction volume this year.

Source: STR, JLL

U.S. — A safe haven for investment

Countries such as India, China, Spain and the United Arab Emirates, which are expected to observe outsized growth above that of the U.S., each face unique market forces that heighten each country's investment risk potential. These factors include demonetization, poor consumer consumption, challenges of working with a more protectionist government or ongoing geopolitical issues.

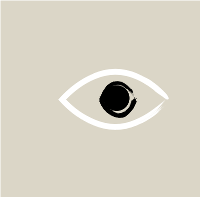
Looking ahead, the U.S. is expected to observe GDP growth above 2.0% in 2017 and 2018. Despite the fact that this performance places the U.S. in 7th place behind the noted countries, the U.S. stands to benefit from a greater sense of economic stability anticipated from the current administration's pro-business policies and proposed corporate tax changes.



Source: Oxford, JLL
Note: Countries in the chart are ordered from largest to smallest GDP growth forecast for 2017. The red dots represent GDP growth in 2016.

Finding ways to deal with alternative accommodations

Although industry participants acknowledge that alternative accommodations are here to stay, signs point to their slowing growth:



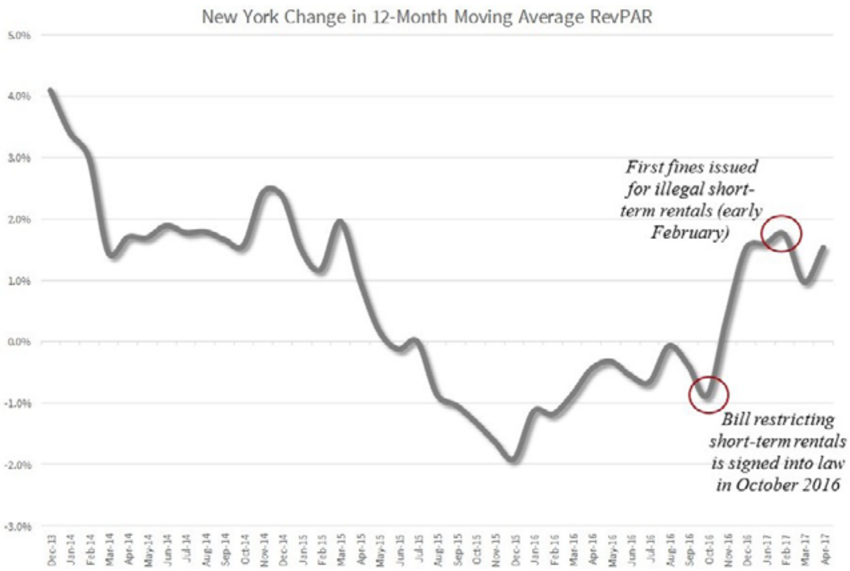
Recent AHLA and multistate report scrutinizes Airbnb for its secret tax deals with cities and states across the country. This has raised awareness and has incentivized city revenue officials to work on creating a new model legislation that requires equal treatment for both lodging and short term rentals in their tax remittance agreements.

The legality of Airbnb has come under greater review in gateway cities, such as New York and San Francisco resulting in the passing of laws restricting Airbnb rentals. The next page has a case study where we analyze the immediate impact this newly enacted policy has had on the New York market.

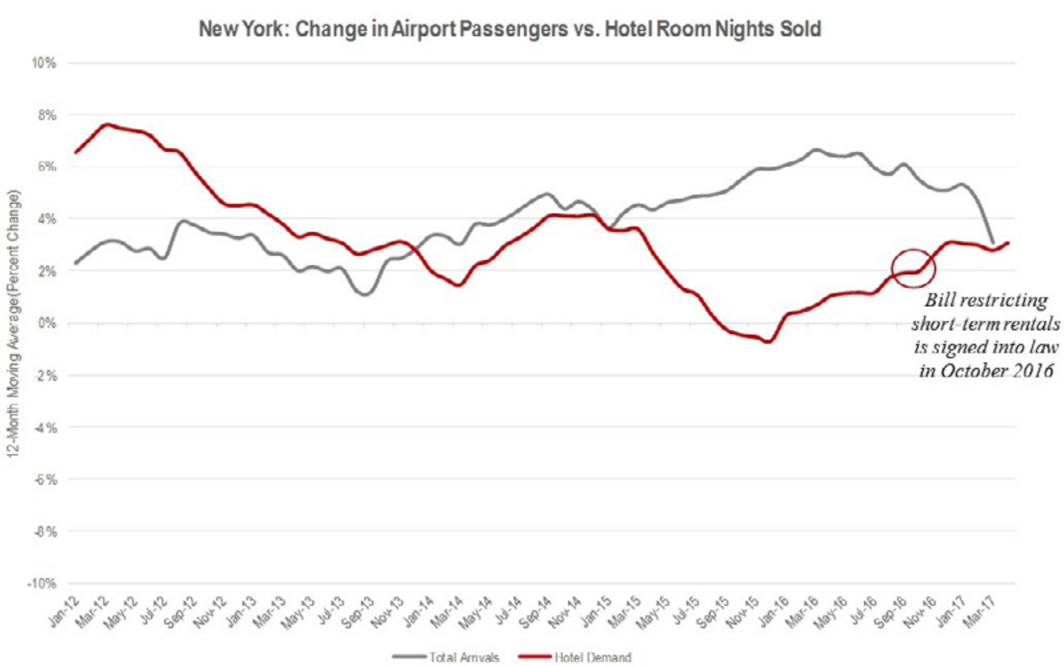
Brands are evolving to better compete. Some major brands are targeting traveling families and groups of friends by creating communal spaces such as a kitchen and lounge areas outside rooms. Other brands are introducing new brands to their portfolios as a way to appeal to more price-sensitive millennials and their desire for greater human connections.

Case study — New York

After the introduction of the bill restricting short-term rentals, hotels have posted several consecutive months of positive growth in New York.



Relationship between passenger arrivals and room nights sold weakened significantly in 2015 and 2016 but is moving back in sync. A plausible explanation is the impact of alternative accommodations, which are now again more restricted.

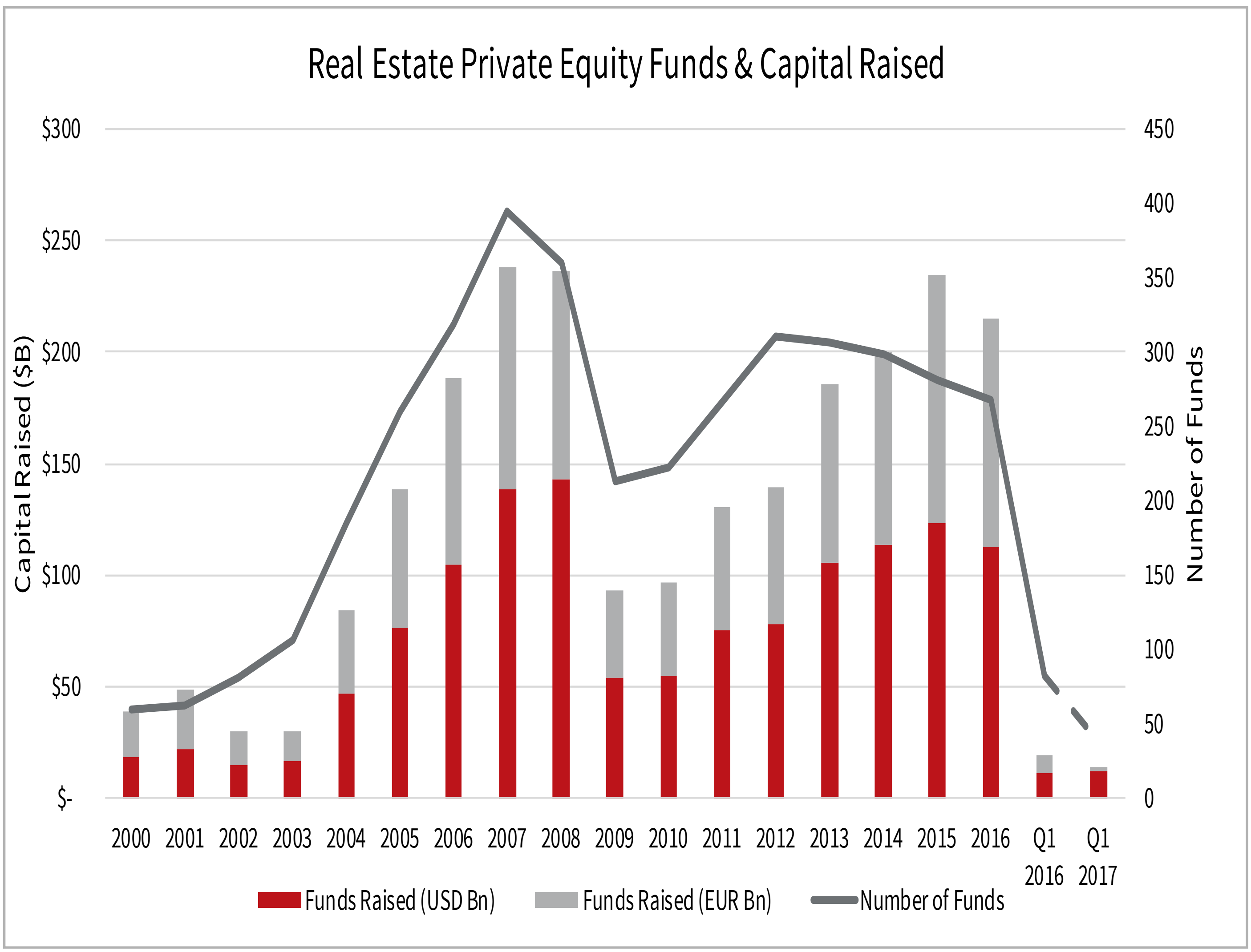


Source: The Port Authority of New York and New Jersey, STR, JLL
Note: Figures pertain to all hotels in the MSA.

Private equity reigns king as top hotel buyer

According to Preqin research, private real estate fundraising reached an all-time high in 2016, with 525 active funds and over $225 billion in capital raised. Q1 2017 activity has declined relative to Q1 2016, with $15 billion capital raised as compared to $26 billion. Although the momentum may be slowing, funds closed since the start of 2013 have raised more capital than those closed in the 2006-2008 period. 2017 levels are expected to be in line with 2016 levels or slip moderately.

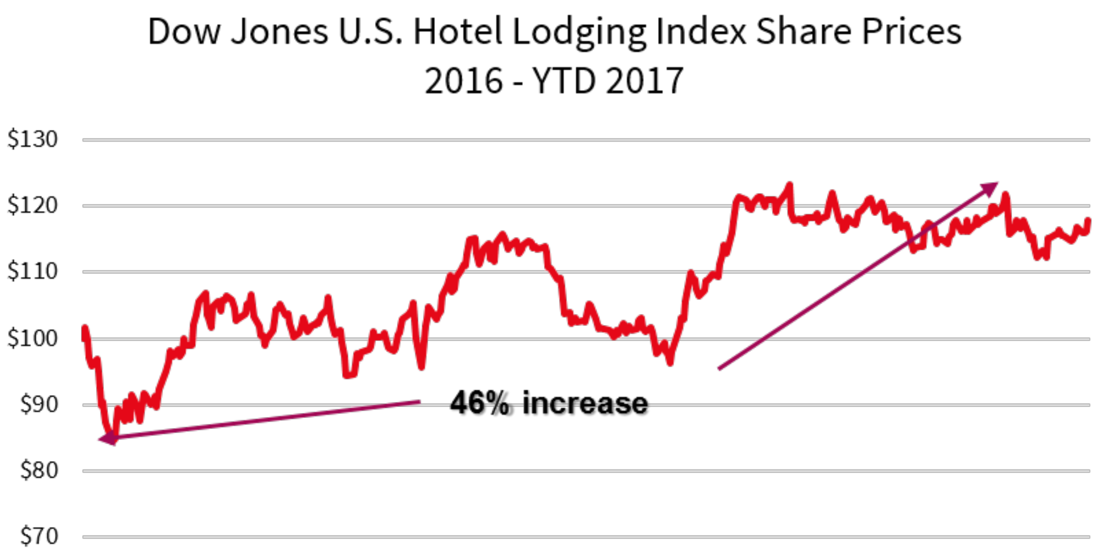
Fund managers have a strong appetite for real estate and, due to the favorable risk-adjusted returns, private equity capital has targeted the U.S. lodging market. In fact, the buyer group invested **over $2.3 billion** in the first five months of 2017. At nearly $8 billion in total U.S. hotel transactions for YTD May 2017, private equity accounts for **30%** of total volume and is expected to continue being a prominent acquirer for the remainder of the year.

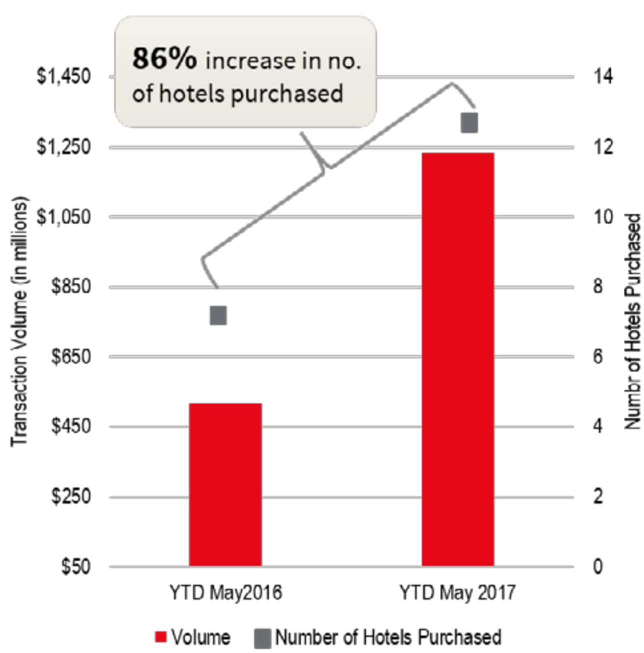


Source: Preqin, JLL latest information available

But count Public REITs in

The Dow Jones U.S. Hotel Lodging Index has followed an upward trend in early 2017 and is expected to continue moving in this direction driven by positive economic indicators (global middle class growth, low unemployment) and general optimistic sentiment surrounding late 2017 and 2018 RevPAR growth. This positive performance has motivated the buyer group to become more active as it has acquired over $1 billion in hotel assets through YTD May 2017.



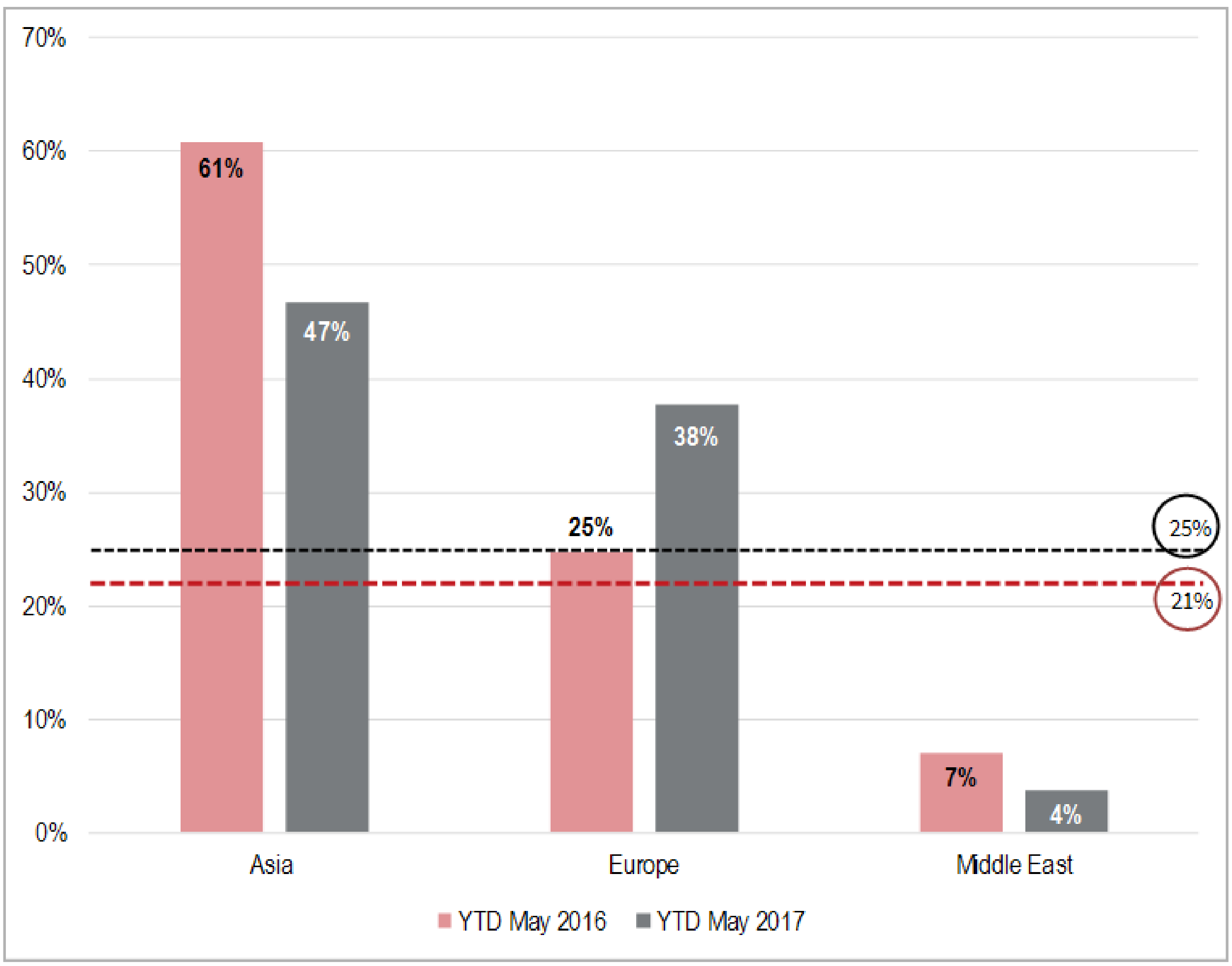


Source: The Wall Street Journal, JLL

Foreign investment remains strong and diverse

Off-shore investment continues to be drawn to the U.S. as this buyer group accounted for 25 percent of volume through YTD May 2017, **a 4 percentage point increase** as compared to the same period in 2016. As anticipated as of late 2016, Mainland Chinese investment in U.S. hotels has started to moderate, observing a decrease as a proportion of total off-shore investment of approximately 14 percentage points period over period.

Nonetheless, capital from Asia continues to account for the largest proportion of off-shore investment in the market. European buyers have emerged as a strong off-shore acquirer, in part attributable to the remaining uncertainty surrounding the aftermath of the E.U. Referendum vote and the hung parliament that resulted from the recent U.K. election.



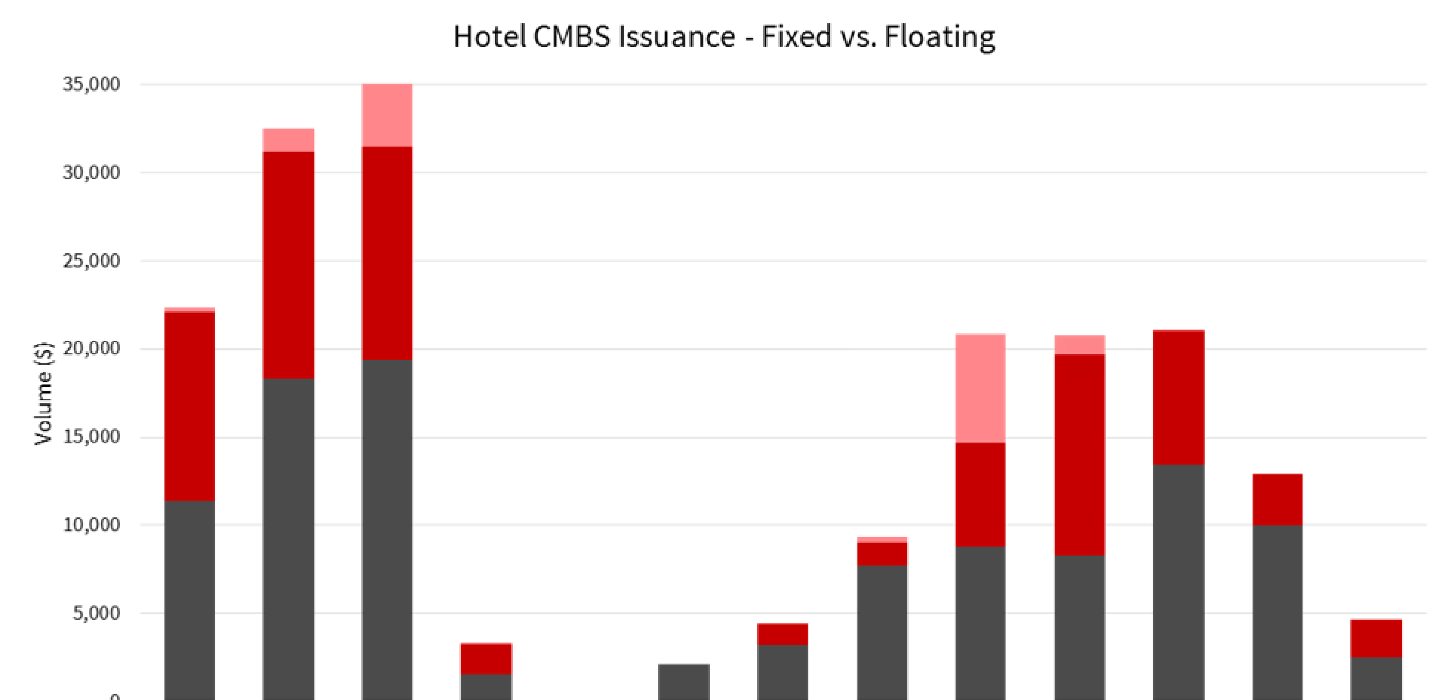
Source: JLL
Note: The black dotted line represents total off-shore investment in YTD May 2017. The red dotted line represents total off-shore investments for YTD May 2016.

Overview of hotel debt capital markets

CMBS — In the first half of 2017, lenders have been competing to finance quality hotel assets, influenced by healthy GDP growth expectations and a significant amount of debt liquidity. Bid ask spreads on deals have narrowed significantly as compared to 12 months ago.

Debt Fund Lending — Debt funds have been very active financing sources for transitional hotel assets and/or assets undergoing significant capital improvements. Debt funds provide the most flexible debt capital and are willing to lend at up to 75% loan-to-value (“LTV”) at spreads ranging in the high-300 bps to mid-400 bps over LIBOR.

Bank Lending — Banks are generally providing the lowest cost of capital for all but very large, lower leverage financings. Banks are willing to lend at up to 65% LTV at spreads ranging in the high-200 bps to mid-300 bps over LIBOR.



	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	YTD May 2017
Mixed	203.7	1,323.9	5,253.1	67.0	4.0	0.0	45.4	365.3	6,144.4	1,099.0	78.5	0.0	0.0
Floating	10,742.8	12,846.4	12,151.3	1,764.4	0.0	0.0	1,230.5	1,323.2	5,854.1	11,395.0	7,557.0	2,889.9	2,142.6
Fixed	11,398.9	18,337.5	19,360.5	1,527.0	0.0	2,150.8	3,208.8	7,699.6	8,820.6	8,314.9	13,448.3	10,019.1	2,505.3

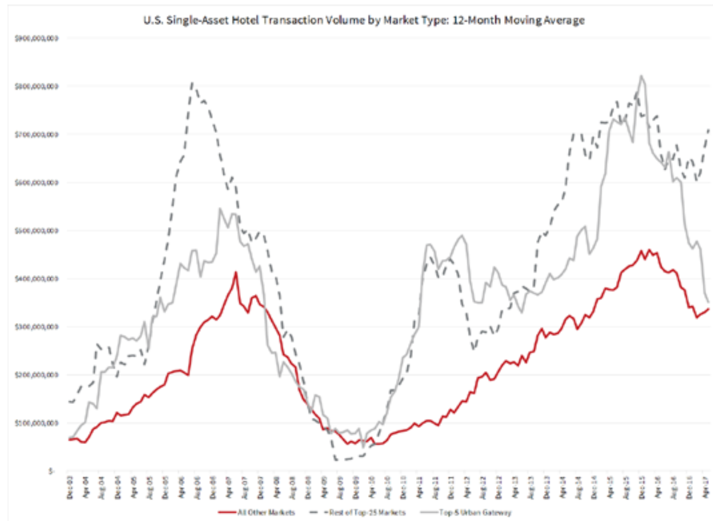
Source: Commercial Mortgage Alert, JLL latest information available

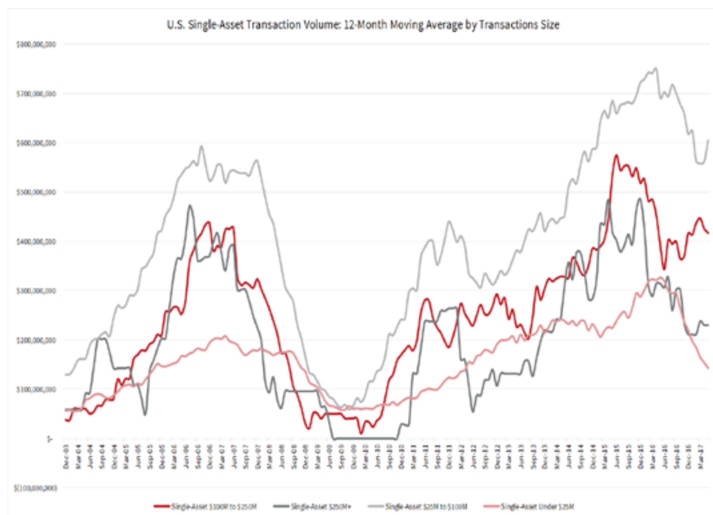
Unlocked potential in hotel transaction volume?

While transaction volume in the top-five urban gateways has slowed notably, **the rest of the top markets are holding up well and we expect more opportunities to become available during the balance of 2017 and into 2018**.

Similarly, it is the large single-asset transactions ($250M+) which have slowed while **deals sought by REITs have held up well**. Interestingly, deals under $25M have slowed the most, likely attributable to the fact that the greatest proportion of hotels sold over the analyzed period represents full service upscale hotels, which typically sell at higher price points.

Given the amount of debt and equity capital seeking hotel transactions, the primary factor holding down transaction volume is the lack of property available to purchase.





Source: JLL
Note: Top-five urban gateway markets represent: New York, Boston, Los Angeles, San Francisco, and Miami.

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