

CBRE HOTELS

The World's Leading Hotel Experts.



HOTELS

CBRE HOTELS & CBRE HOTELS' AMERICAS RESEARCH

JUNE 2, 2016

Inland Empire Hotel Market Trends

**“Performance at the Peak”**

**CBRE**

# LODGING INDUSTRY UPDATE

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- ✓ Some Happy Facts & Much to Think About
- ✓ The Economy – What Matters?
- ✓ Our Forecasts – National & Regional
- ✓ The Supply Story
- ✓ A Look at Cap Rates & Transaction Activity

# BY 2015, THE HOTEL INDUSTRY WILL HAVE ACHIEVED:

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- A fifth year of accommodated demand in excess of the pre-recession peak of 2.8 million room nights.
- Six consecutive years of increased occupancy—the longest since 1988.
- An occupancy level of 65.5 percent, the highest level of occupancy ever recorded by STR, Inc.
- 14 of the 55 markets in *Hotel Horizons*® universe will achieve their highest occupancy levels in the past 25 years.
- 49 of 55 markets are above their long run average occupancy level.



# MUCH TO THINK ABOUT

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## WHY BE HAPPY?

High Occupancy Levels

INFLATION & INTEREST  
RATES ARE LOW

WAGES INCREASING

PROFITS CONTINUE TO  
GROW

## WHY BE CONCERNED ?

Supply growth accelerating

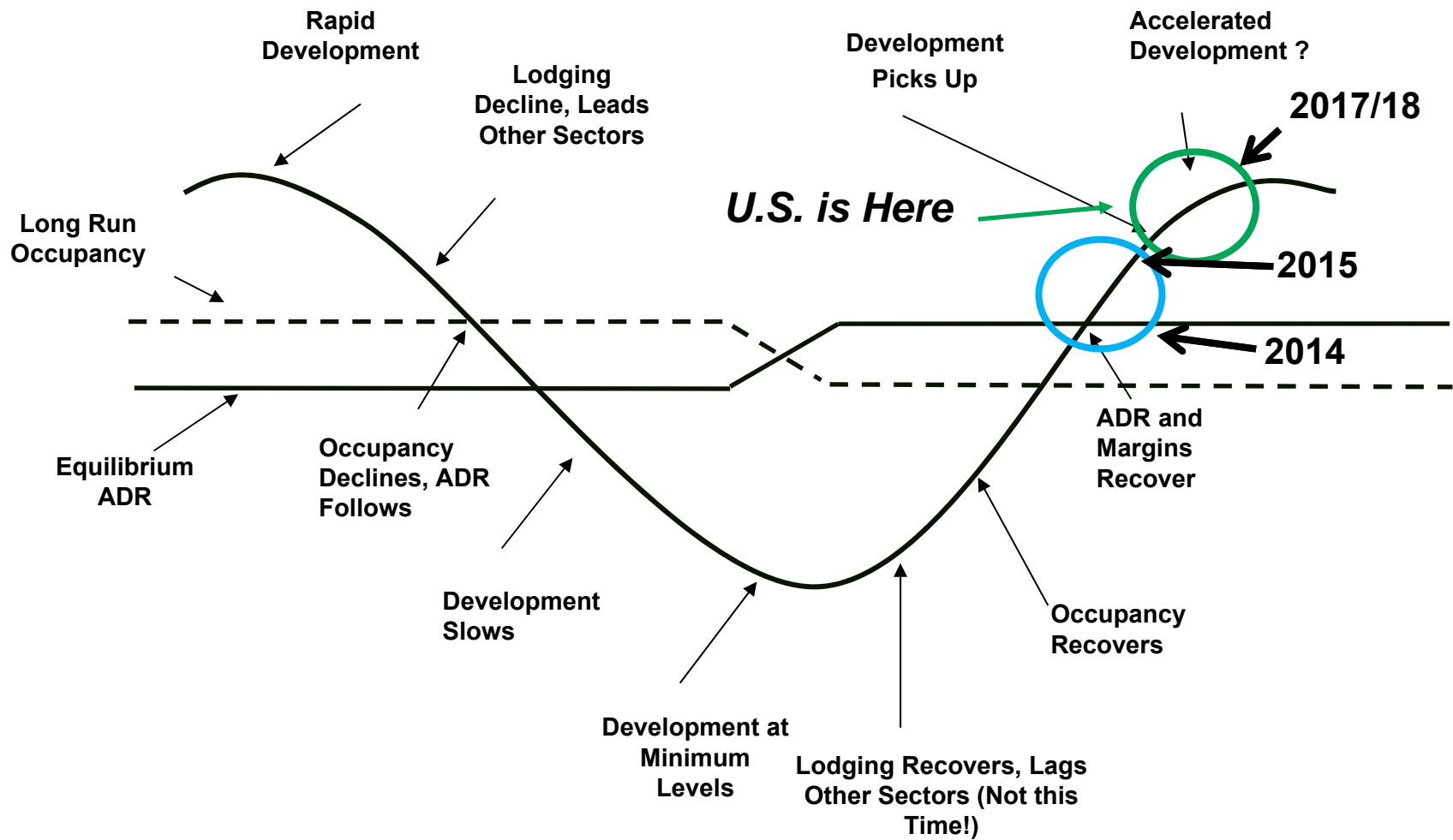
INFLATION & INTEREST  
RATES GOING UP?

WAGES INCREASING

EXPENSE GROWTH  
ACCELERATING

# THE HOTEL MARKET CYCLE

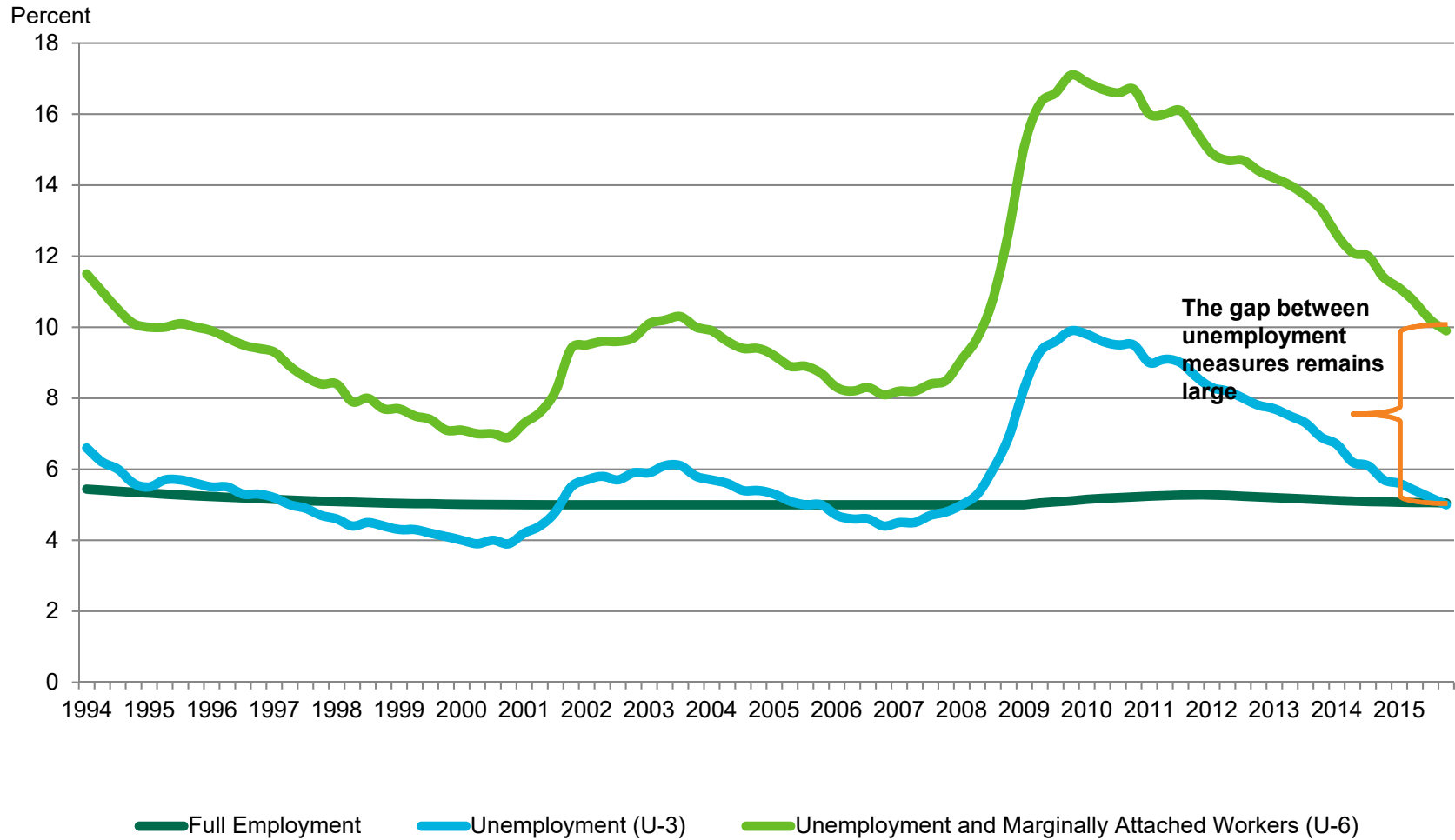
## Our Opinion



# WHAT HISTORY TELLS US ABOUT WHAT MATTERS

- A Lot:
  - Employment and Jobs
  - Personal Income
  - GDP
- Somewhat:
  - Corporate Profits
  - Leading Economic Indicators
- Not So Much:
  - Foreign Exchange Rates

# THE US ECONOMY IS ACHIEVING FULL EMPLOYMENT FOR THE FIRST TIME SINCE 2007

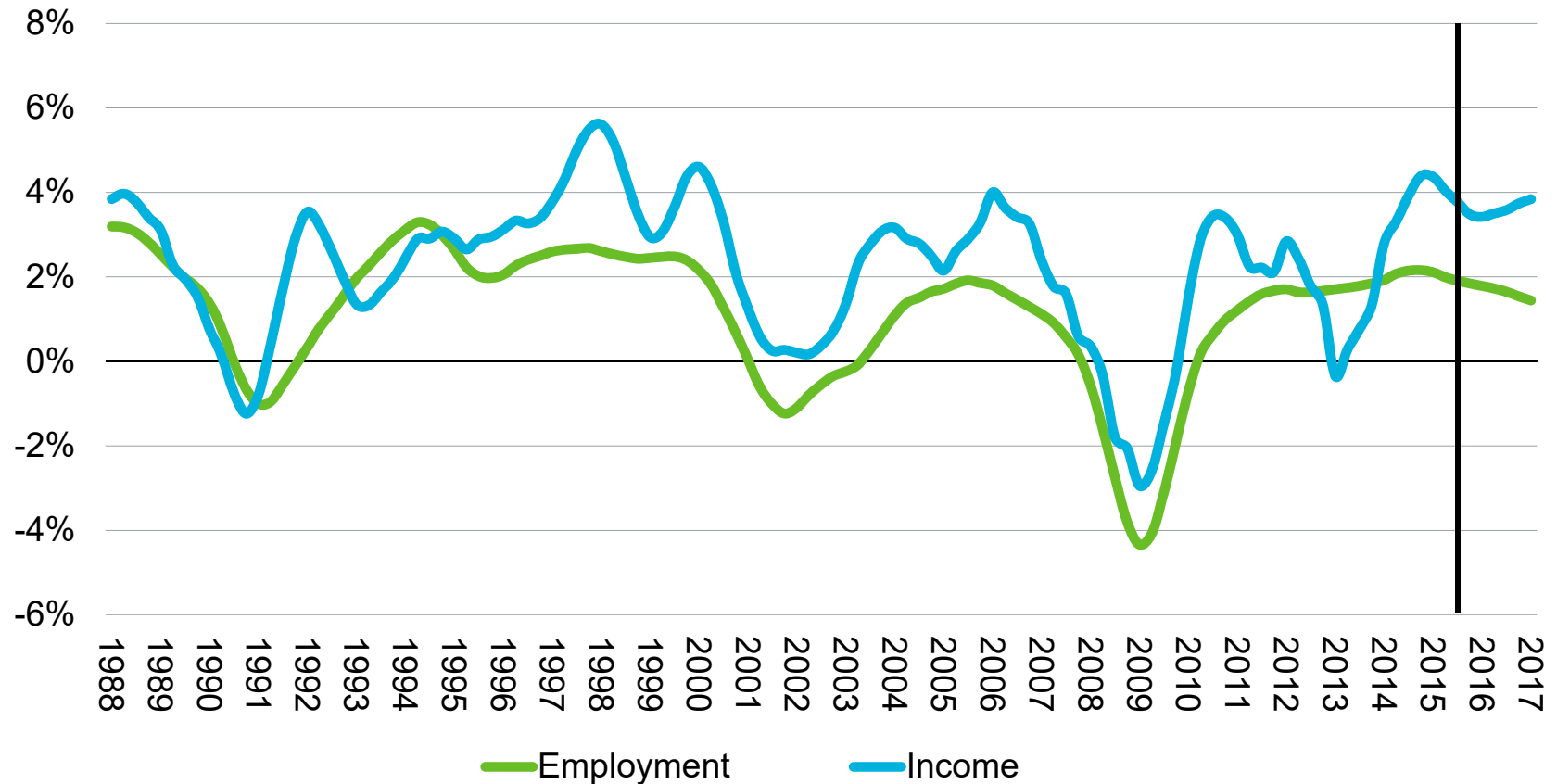


Source: Moody's Analytics, PKF Hospitality Research | CBRE Hotels, Q1 2016.

# HIGH CONCERN AND POSITIVE: INCOME AND EMPLOYMENT

The economy is at full employment for the first time since 2007 and income growth is strong

Y-o-Y Change



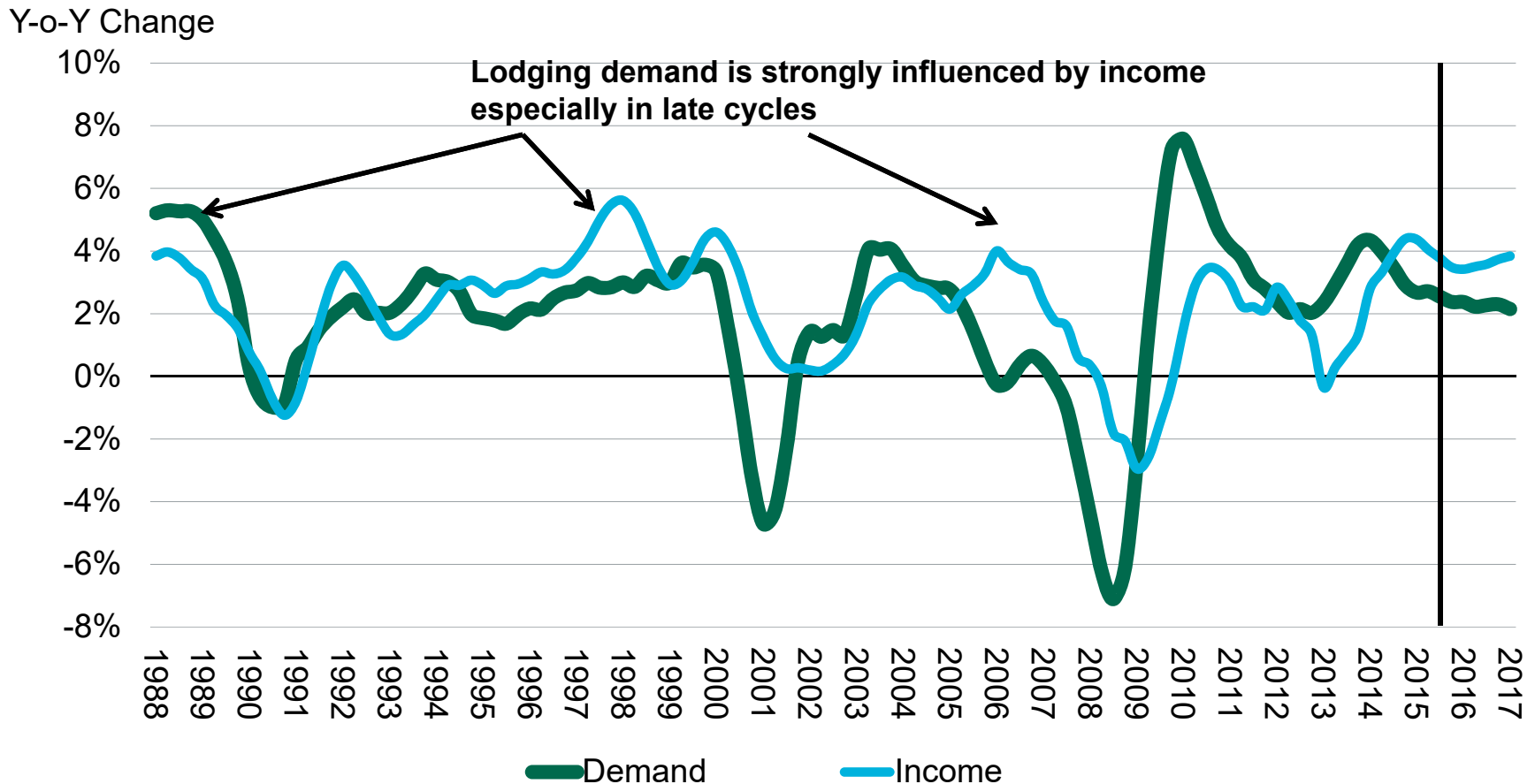
Source: STR, Inc. , CBRE Hotels' Americas Research, CBRE Econometrics Advisors Q1 2016.





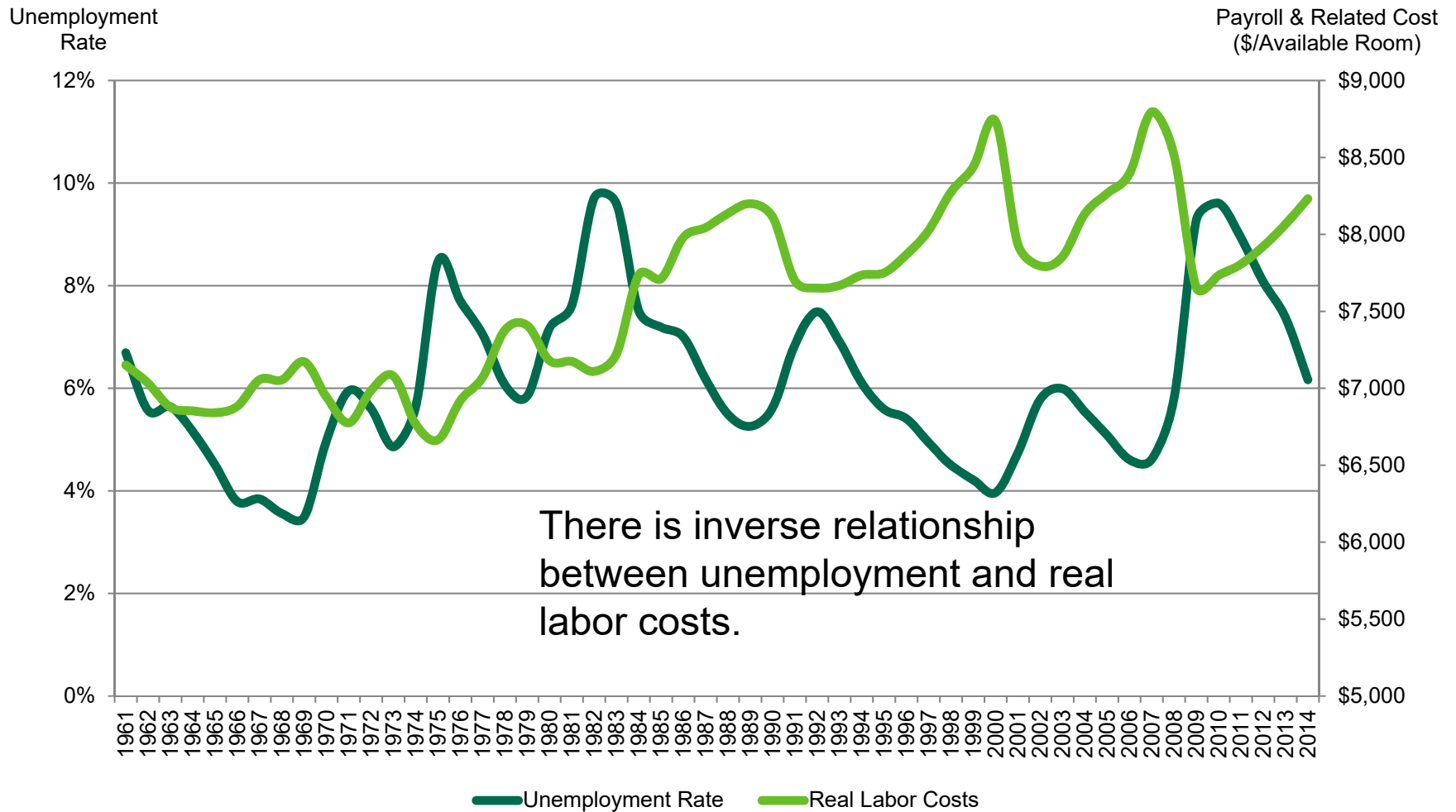
# HIGH CONCERN AND POSITIVE: INCOME

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Source: STR, Inc. , CBRE Hotels' Americas Research, CBRE Econometrics Advisors Q1 2016.

# AS THE ECONOMY REACHES FULL EMPLOYMENT LABOR COSTS ARE LIKELY TO RISE



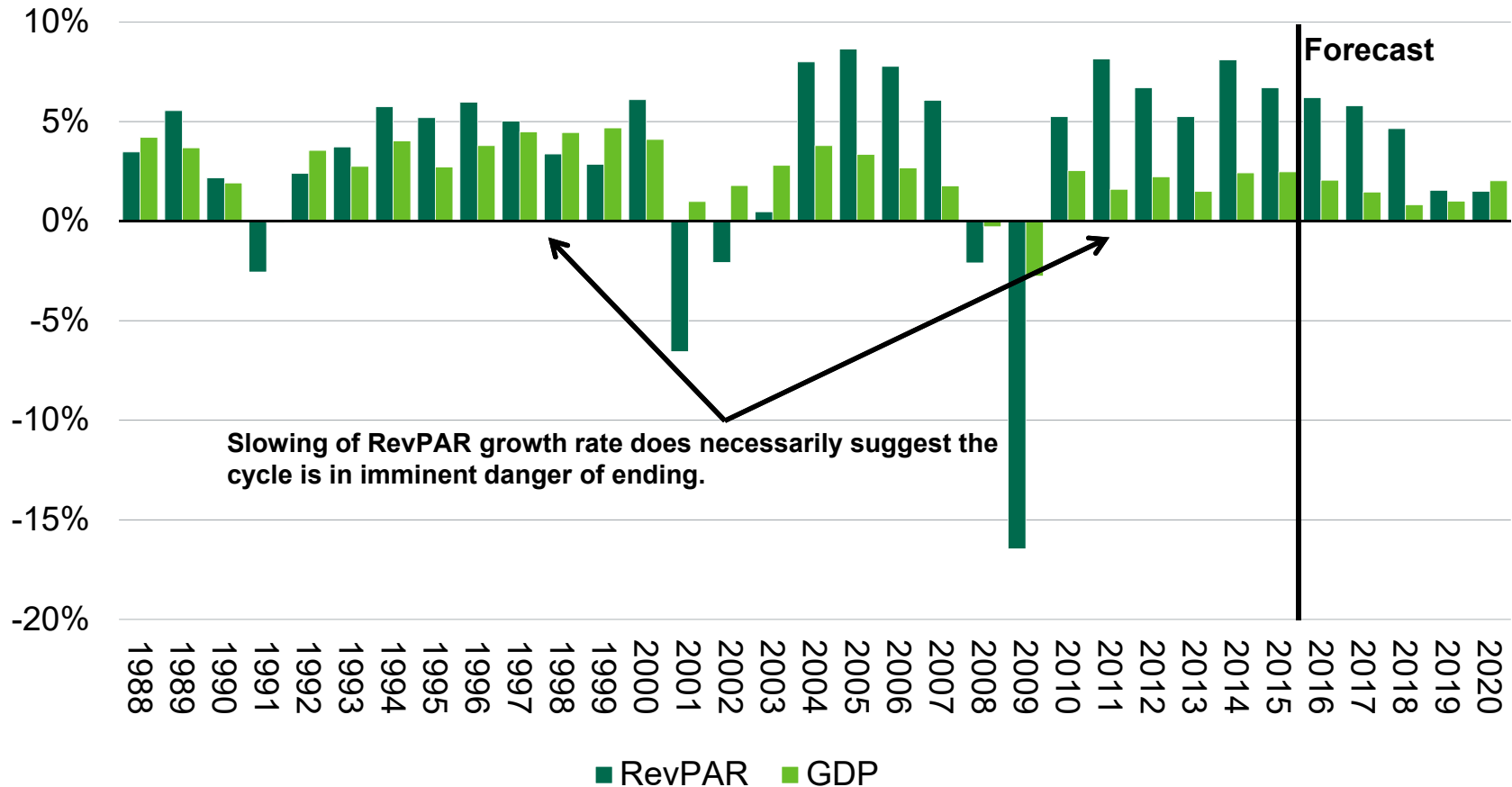
Source: Moody's Analytics, PKF Hospitality Research | CBRE Hotels, Q1 2016.



# HIGH CONCERN: GDP AND REVPAR

## RevPAR rate of change closely tracks GDP changes

Y-o-Y Change



Source: STR, Inc. , CBRE Hotels' Americas Research, CBRE Econometric Advisors Q1 2016.

# BASELINE ECONOMIC FORECAST

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## Expected Case Scenario

### **Key Assumptions:**

- GDP growth remains between 2-3% and the unemployment rate remains below 5% through 2018. Real incomes will rise by over 3% for the next 3 years.
- The Federal Reserve is expected to slowly normalize interest rates as the economy achieves full employment in 2016 and short-term interest rates will reach 3.5% in 2018.
- Oil prices are thought to be near their bottom and are expected to make their way slowly back, supported by a sharp pullback in investment in oil production. Oil prices are not expected to top \$90 per barrel for another decade.
- The federal government's fiscal situation continues to improve. Political brinkmanship over the budget will not be a threat to the economy until 2017 at the earliest.

# U.S. BASELINE FORECAST

## Occupancy Peaks and ADR Growth Picks Up

	Long Run Average	2013	2014	2015	2016F	2017F
Supply	1.9%	0.6%	0.7%	1.1%	1.8%	2.1%
Demand	2.0%	2.0%	4.2%	2.8%	1.6%	2.0%
Occupancy	62.0%	62.2%	64.4%	65.5%	65.4%	65.3%
ADR	3.0%	3.7%	4.5%	4.4%	4.3%	4.9%
RevPAR	3.2%	5.2%	8.1%	6.2%	4.2%	4.7%

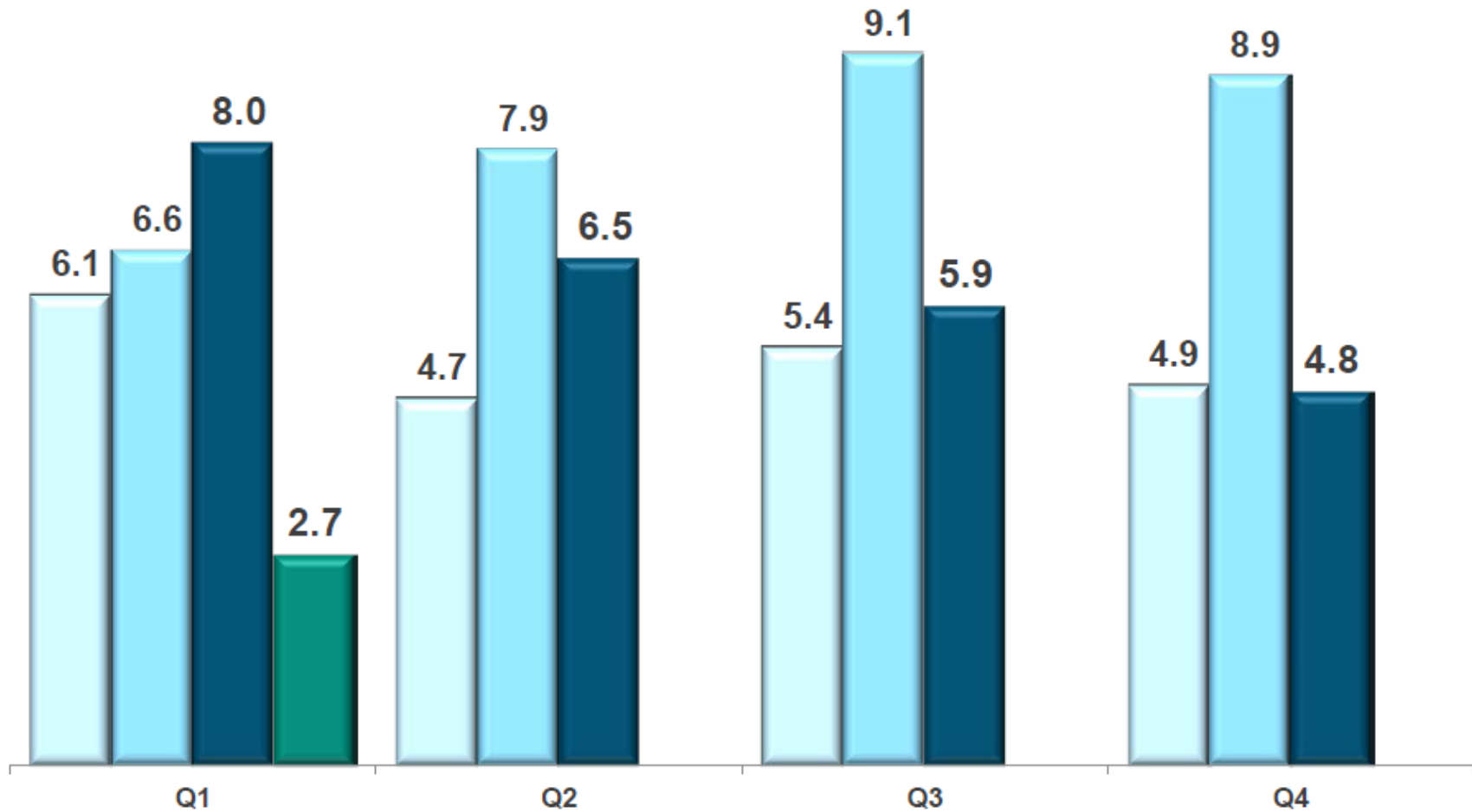
RevPAR driven by ADR Growth

Source: CBRE Hotels' Americas Research -- Hotel Horizons® June – August 2016 (preliminary); STR, Inc.

# RECENT U.S. QUARTERLY REVPAR % CHANGE

Weak Q1 2016

■ 2013 ■ 2014 ■ 2015 ■ 2016



# RECENT U.S. QUARTERLY REVPAR % CHANGE

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But...Weak Q1 2016 Dragged Down by 2 Markets

<b>Total US YTD:</b>	<b>+2.7%</b>
NYC:	-1.2%
Houston:	-9.5%

<b>Total US excluding NYC &amp; Houston:</b>	<b>+3.5%</b>
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# SOUTHERN CALIFORNIA HOTELS HISTORICAL ANNUAL PERFORMANCE

Area	YE 2014	YE 2015	YoY Change
Orange County	76.4%	78.7%	3.0%
Los Angeles County	78.7%	79.6%	1.2%
Inland Empire	71.0%	75.1%	5.9%
San Diego County	74.6%	76.4%	2.4%

Area	YE 2014	YE 2015	YoY Change
Orange County	\$135.58	\$144.19	6.3%
Los Angeles County	\$147.33	\$158.27	7.4%
Inland Empire	\$93.11	\$99.76	7.1%
San Diego County	\$142.01	\$150.66	6.1%





# SOUTHERN CALIFORNIA HOTELS FORECASTED PERFORMANCE

Area	YE 2015	2016F	YoY Change
Orange County	78.7%	78.2%	-0.6%
Los Angeles County	79.6%	80.8%	1.5%
Inland Empire	75.1%	76.5%	1.8%
San Diego County	76.4%	76.7%	0.4%

Area	YE 2015	2016F	YoY Change
Orange County	\$144.19	\$152.62	5.8%
Los Angeles County	\$158.27	\$168.18	6.3%
Inland Empire	\$99.76	\$105.73	6.0%
San Diego County	\$150.66	\$156.71	4.0%





## THE SUPPLY STORY



## QUESTION:

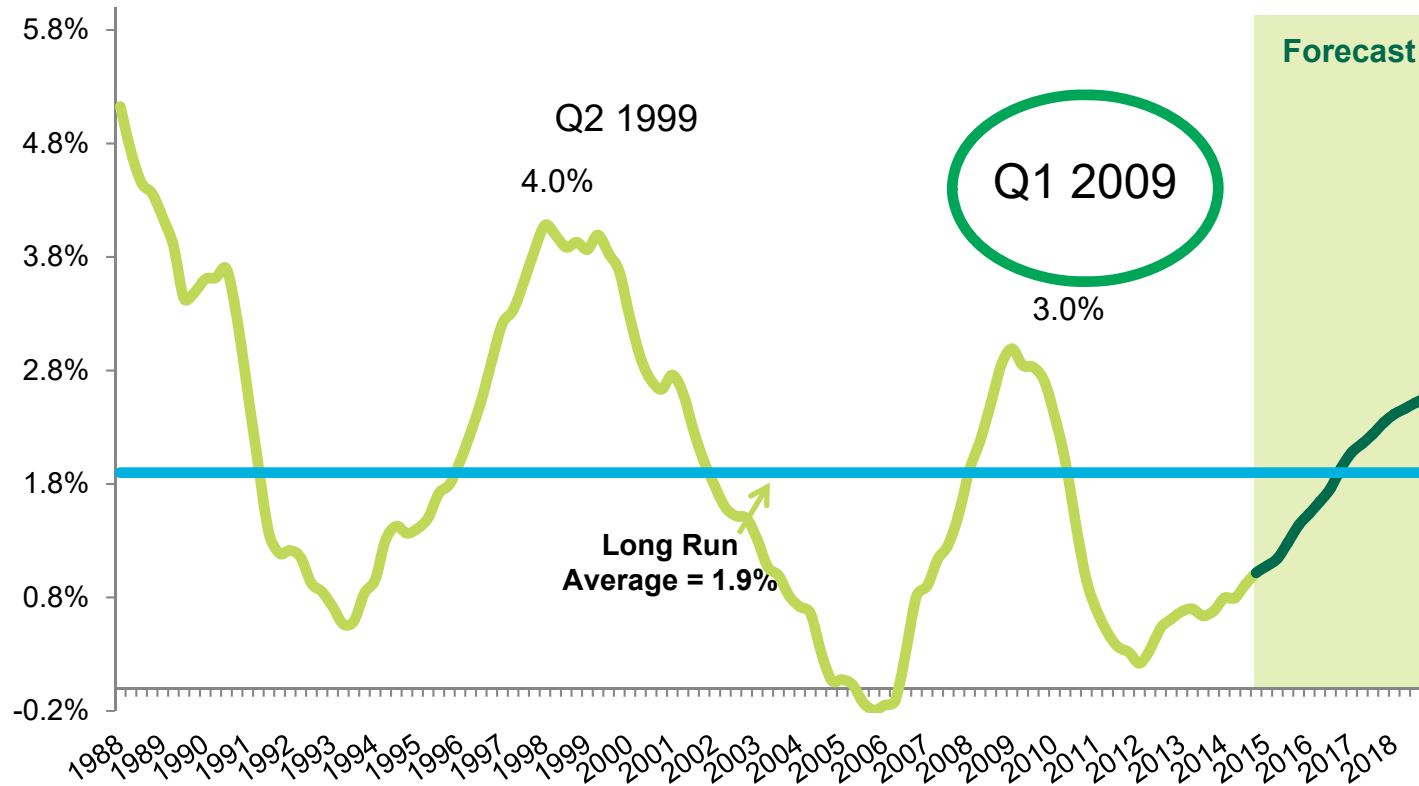
When Was Hotel

Overbuilding

Last a Concern?

# U.S. SUPPLY CHANGE

When did we hit our last peak number of new hotels entering the market?



Source: PKF Hospitality Research, STR, Inc.

## TODAY VS. THE PREVIOUS PEAK OF CONSTRUCTION ACTIVITY

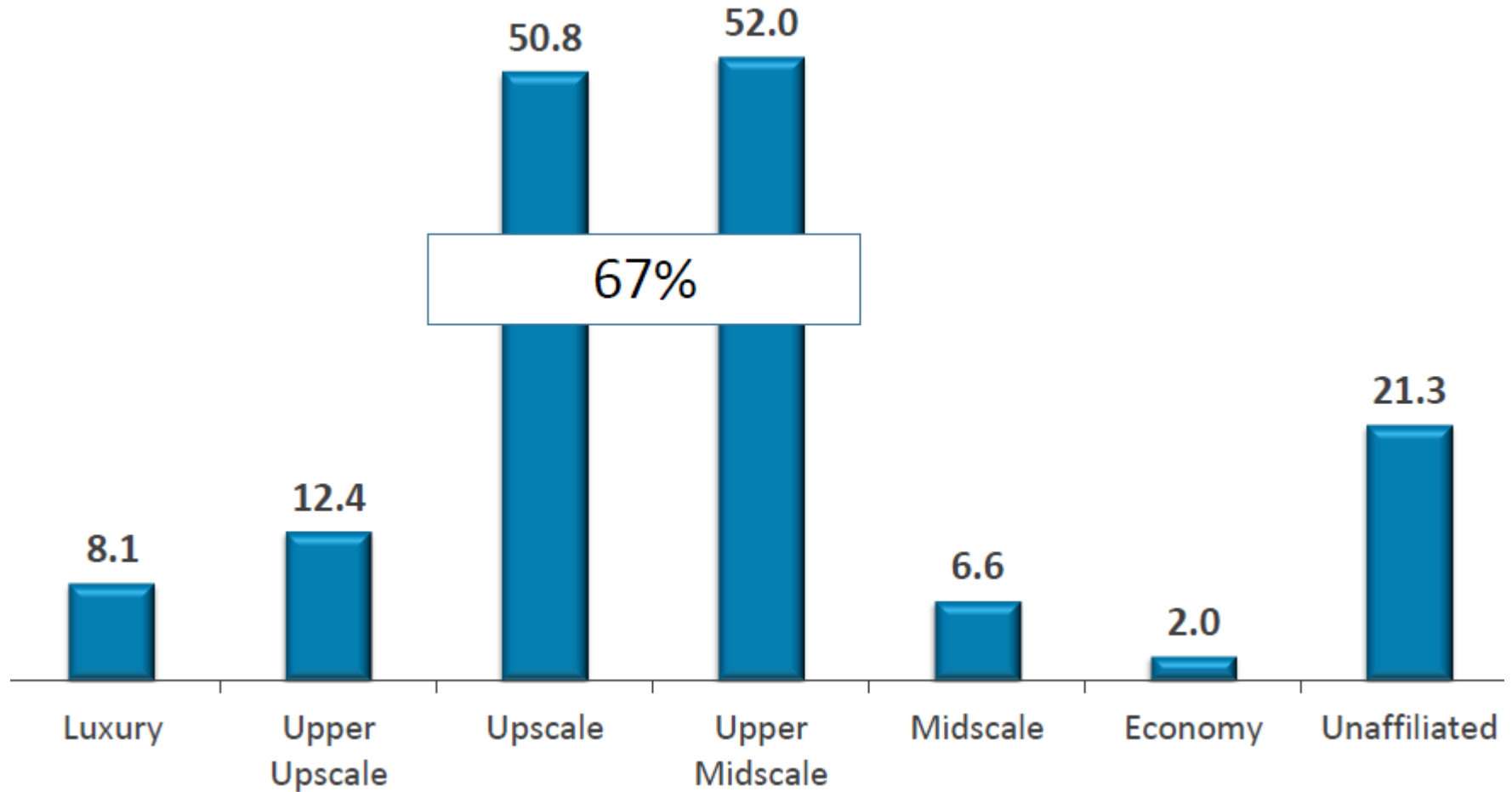
U.S. Pipeline, Number of Rooms by Phase, April 2016 and March 2008

<i>Phase</i>	<i>Apr-2016</i>	<i>Q1/2008</i>	<i>% Difference Change</i>
<b>In Construction</b>	<b>174,996</b>	<b>207,468</b>	<b>-15.7%</b>
<b>Final Planning</b>	<b>234,638</b>	<b>113,419</b>	<b>107%</b>
<b>Planning</b>	<b>142,331</b>	<b>344,363</b>	<b>-58.7%</b>
<b>Active Pipeline</b>	<b><u>551,965</u></b>	<b><u>665,250</u></b>	<b>-17.0%</b>

Source: STR, Inc.

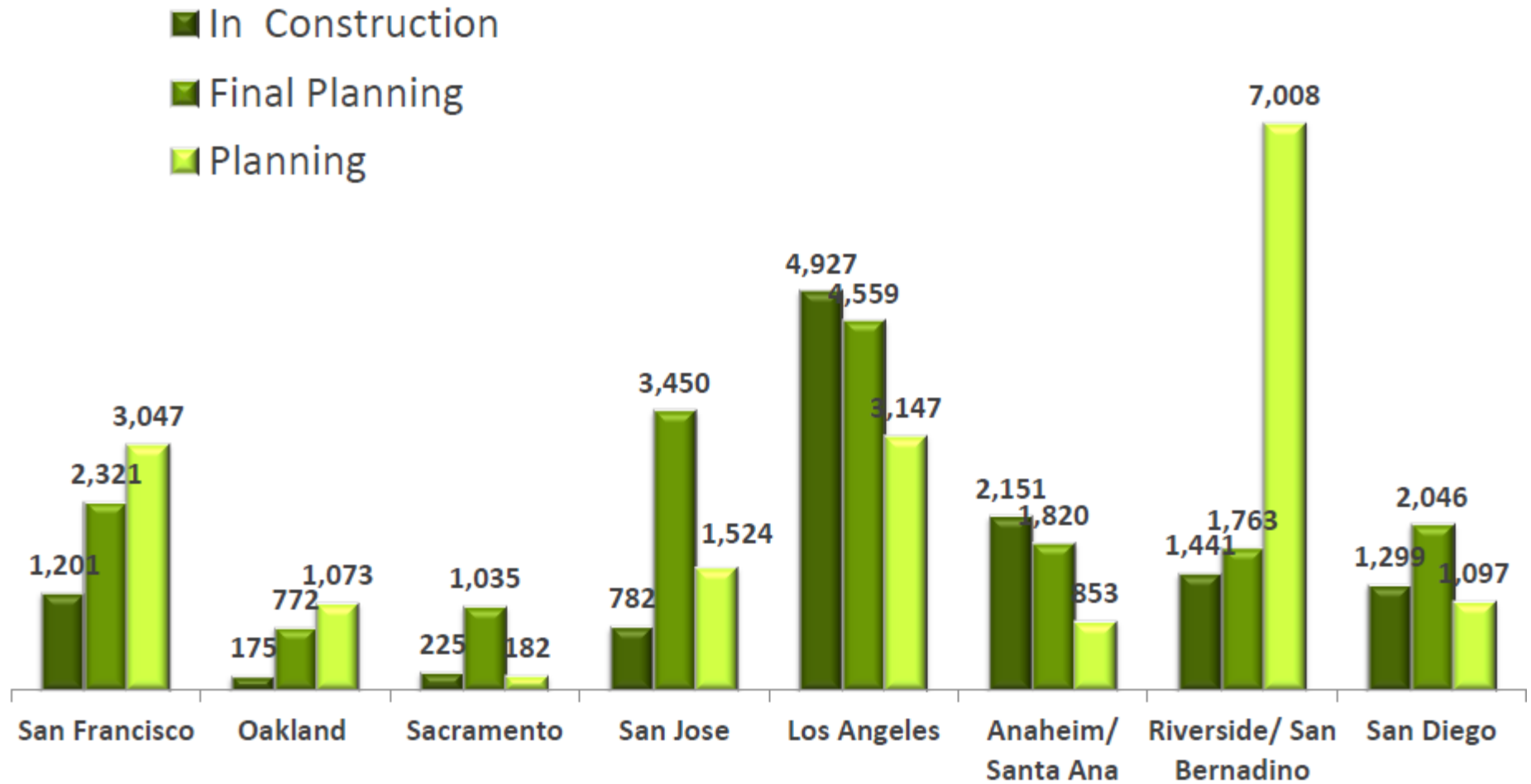
# CONSTRUCTION FOCUSED ON UPSCALE & UPPER MIDSCALE

U.S. Pipeline, Rooms Under Construction ('000s), by Scale, March 2016



Source: STR, Inc.

# PIPELINE (ROOMS): SELECT CA MARKETS



Source: STR, Inc.



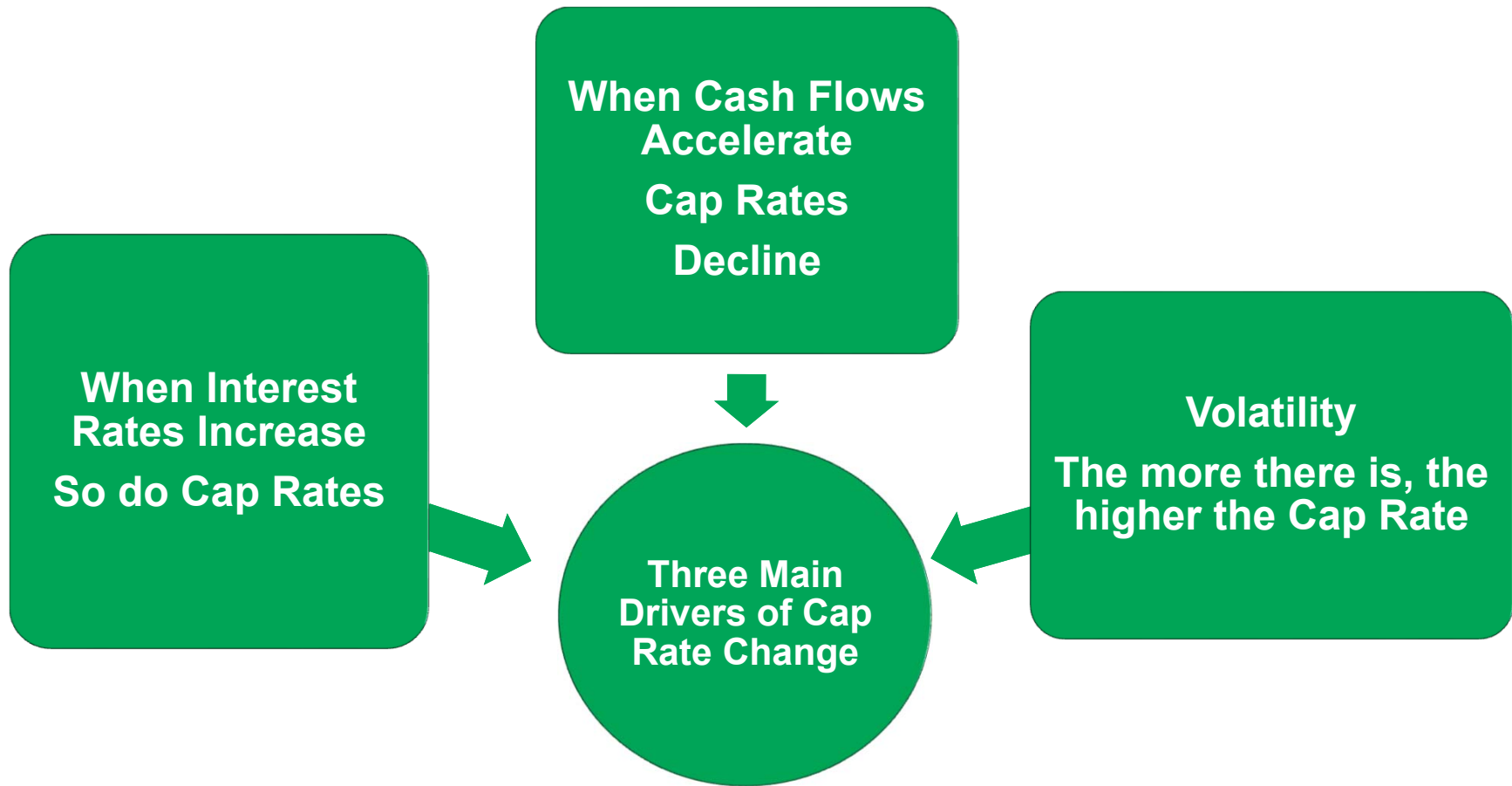
1<sup>ST</sup> QUARTER 2016



**CAP RATE  
EXPECTATIONS  
&  
TRANSACTION  
MARKET UPDATE**

# WHERE ARE HOTEL CAP RATES GOING?

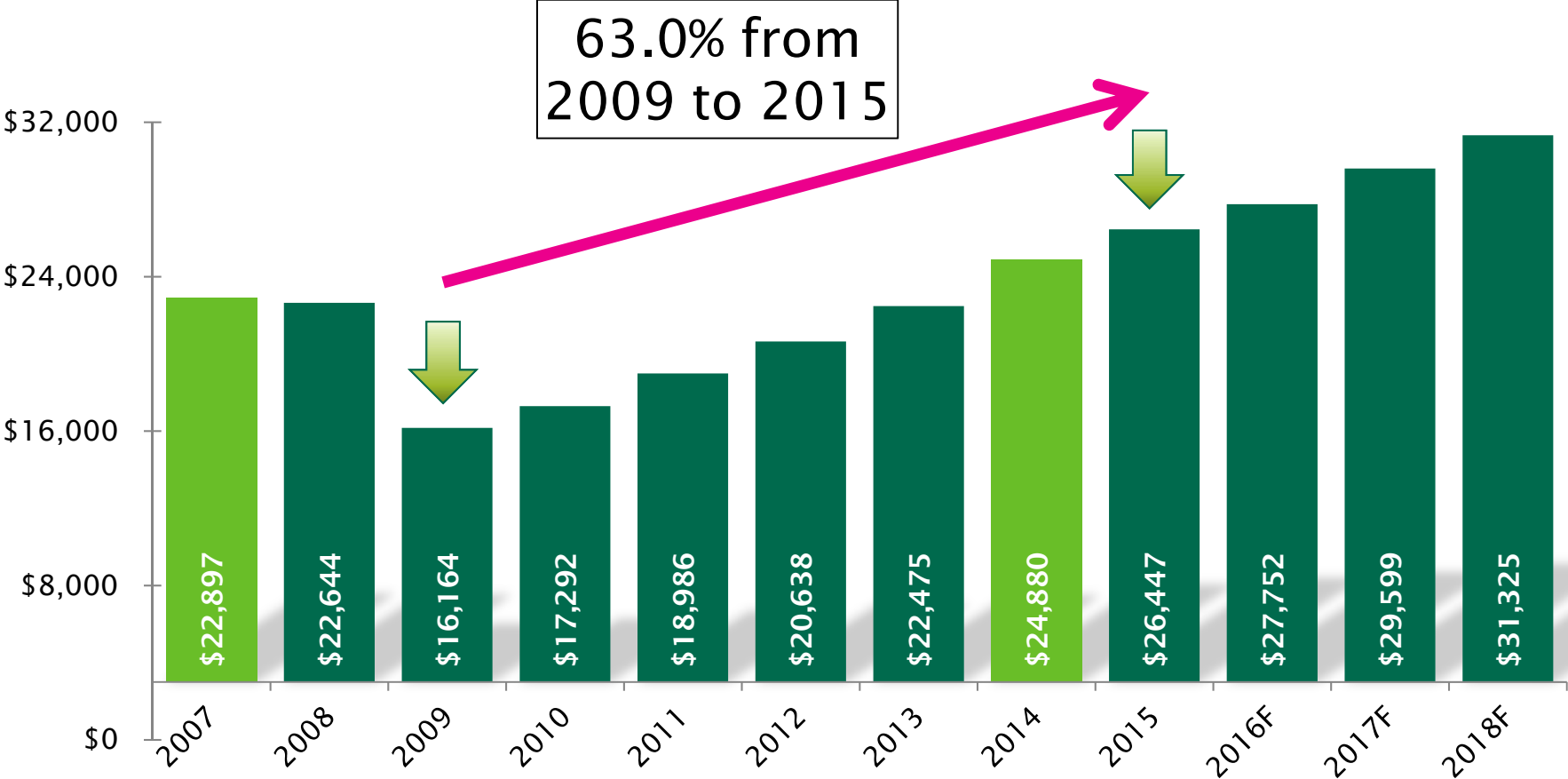
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# 2016 TRENDS® IN THE HOTEL INDUSTRY

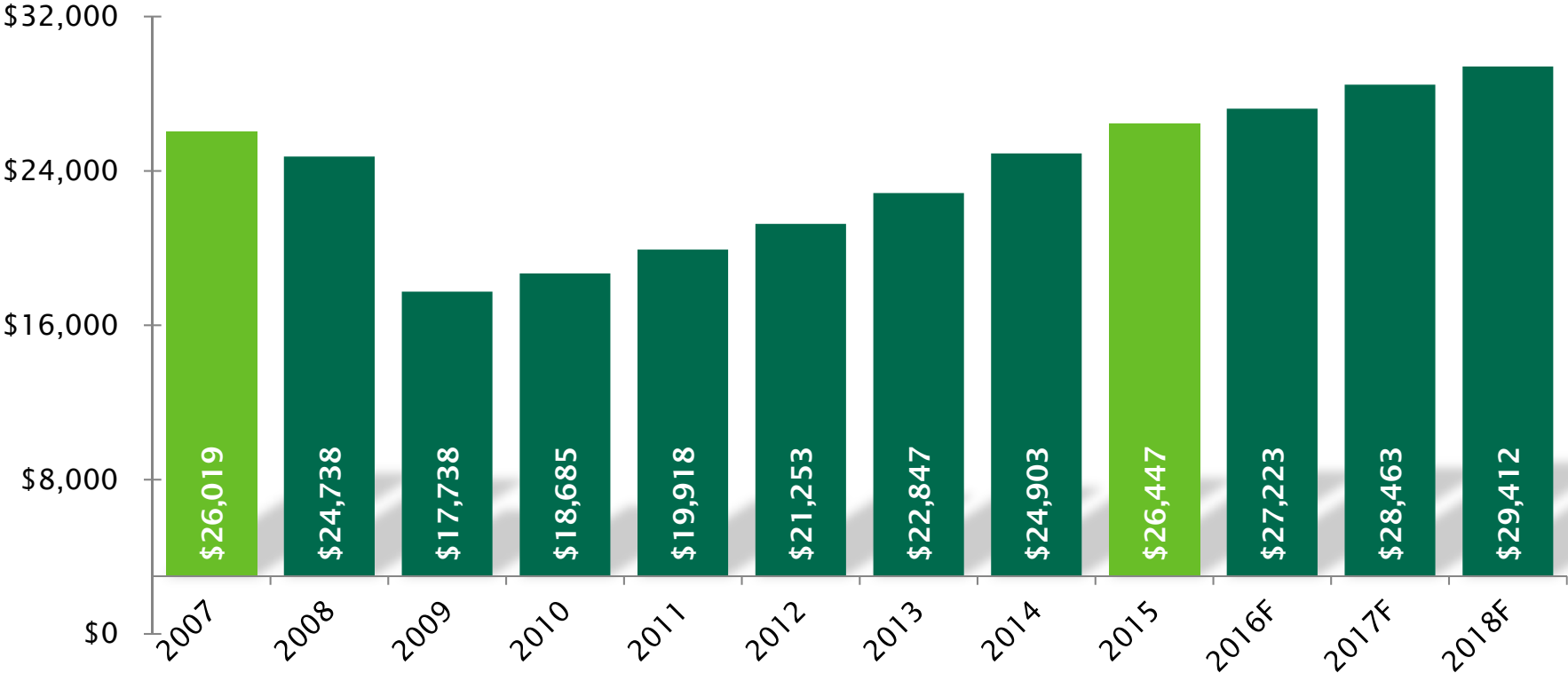
Gross Operating Profit\* - Dollars Per Available Room



Note: \* Before deduction for Management Fees and Non-Operating Income and Expenses  
 Source: 2016 Trends® in the Hotel Industry. June 2016 *Hotel Horizons*® Forecast

# 2016 TRENDS® IN THE HOTEL INDUSTRY

Gross Operating Profit\* - 2015 Constant Dollars Per Available Room



Note: \* Before deduction for Management Fees and Non-Operating Income and Expenses  
 Source: 2016 Trends® in the Hotel Industry. June 2016 *Hotel Horizons*® Forecast

# WHERE ARE CAP RATES GOING? BASED ON MARKET EXPECTATIONS

	10-Year Treasury	Risk Premium (Baa - 10-Yr Treasury)	Real Estate Risk Premium (Hotel Cap Rate – Baa)	Hotel Cap Rate
2010	3.22	1.38	4.32	8.92
2011	2.78	1.11	4.29	8.18
2012	1.81	1.33	4.93	8.07
2013	2.35	1.26	4.42	8.03
2014	2.54	1.07	4.15	7.76
2015	2.14	1.46	4.01	7.61
2016F	1.96	1.29	4.51	7.89
2017F	2.13	1.37	4.62	8.12
2018F	2.25	1.37	4.65	8.27
L.R.A. (1994-2015)	4.46	1.38	3.53	9.37

Forward market view: treasuries will rise slowly

Market risk reverts to the mean

Cap rates will remain below the LRA

# TRANSACTION MARKET OVERVIEW

## U.S Transaction Volume Summary (\$ billion)

Year	Individual	Portfolio	Entity	Total
'07	\$20.0	\$12.3	\$48.4	\$80.7
'08	\$7.9	\$3.7	\$0.0	\$11.6
'09	\$3.0	\$0.2	\$0.0	\$3.2
'10	\$8.0	\$2.2	\$4.1	\$14.3
'11	\$14.3	\$5.8	\$0.0	\$20.1
'12	\$13.8	\$3.7	\$2.9	\$20.5
'13	\$17.4	\$7.5	\$1.1	\$26.1
'14	\$21.9	\$9.9	\$3.0	\$34.8
'15	\$28.9	\$12.3	\$8.2	\$49.4
Period		# Sold	\$/Room	Total
YTD Q1 '15	-	203	\$185,222	\$10.8
YTD Q1 '16	-	314	\$138,361	\$4.9

Source: Real Capital Analytics

# HOTEL CAP RATES

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Type	Primary	Secondary	Tertiary
Luxury	4.50 – 6.75%	7.00 – 7.75%	7.25 – 8.50%
Full-Service	5.25 – 7.50%	7.25 – 8.50%	8.00 – 9.50%
Select-Service	6.50 – 8.50%	8.25 – 9.50%	8.75 – 10.50%
Economy	8.00 – 9.75%	9.50 – 11.50%	11.00 – 12.75%

- Major brand product drives pricing to the lower range of the cap rates
- Management encumbrance adds 100 to 150 bps
- Larger, portfolio deal incentivizes lower-cost-capital and reduces cap rate between 50 and 100 bps

Source: CBRE Hotels

# RECENT IE HOTEL SALES

Inland Empire Recent Hotel Sales							
Sale No .	Hotel	Location	Rooms	Sale Date	Price	\$/Room	Cap Rate
1	Country Inn & Suites	Ontario	115	April 2016	\$13,000,000	\$113,043	5.2%
2	Hyatt Place	Ontario	127	November 2015	20,000,000	157,480	7.1
3	Fmr Hampton Inn	Colton	84	July 2015	5,800,000	69,048	6.5



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# SUMMARY THOUGHTS

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## Operating at the Peak

1. The fundamentals are solid across the vast majority of markets.
2. Elevated industry growth will persist comfortably through 2017 and likely beyond.
3. High occupancy levels will provide the leverage needed to achieve large real ADR increases for the next two-three years.
4. Competition for building materials and labor will continue to present challenges for developers in most markets. Modest (but increasing) hotel construction will be the result for the next two-three years.
5. Above long run average occupancy levels will lead to strong profit growth through 2017, enough to off-set increasing labor costs.
6. Gap between buyer and seller expectation stalling transaction market.
7. Cap rates have risen 50 bps for most assets but remain low for high quality full service and luxury hotels in prime markets.
8. It continues to be a great time to be in the hotel business!