Hotels & Hospitality Group | January 2017

Hotel Investment Outlook 2017

Welcome to 2017

A year of resets and changes stands to make way for a year of stability and greater consistency for investment flows. Our total global expectation for hotel real estate transactions in 2017 is $60 billion, mirroring the level recorded in 2016.

- EMEA is expected to see growth in volumes from approximately $20.5 billion in 2016 to $22.5 billion in 2017.
- Activity in the Americas, after a relatively strong year underpinned by off-shore buyers, is slated to remain flat at up to $31.0 billion.
- Asia Pacific volumes are expected to hold steady at $8.5 billion in 2017.

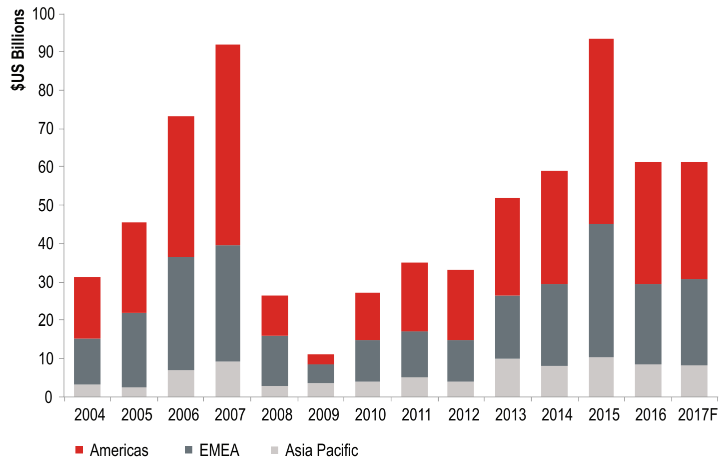
Global Hotel Transaction Volumes

$US Bn	Americas	EMEA	Asia Pacific	Global Total
2016	$31	$20.5	$8.5	$60
2017F	$29 to $31	$22 to $23	$8 to $9	≈$60

Source: JLL

Photo: Atelier für Sonderaufgaben ZERO STAR HOTEL © Null Stern

Global Hotel Transaction Volumes

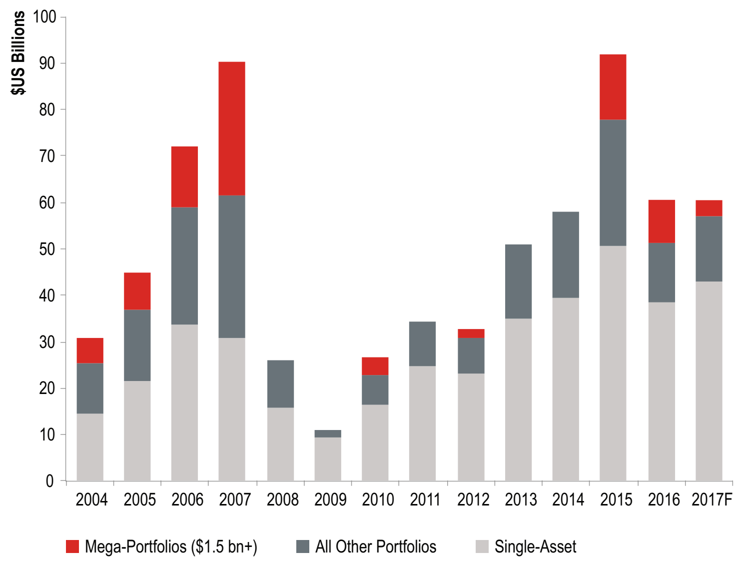


Source: JLL

Transactions in 2017 will generally be driven by funds reaching the end of their hold period and the subsequent restructuring of portfolios, rather than high income growth.

Investors will continue to pursue yield, and move into more secondary and tertiary markets. Transaction structures continue to evolve, and the role and clout of private equity funds is changing. Some markets where hotel performance has turned negative will see more stress in 2017, resulting in potential opportunities for buyers.

Global Hotel Transaction Volumes by Deal Type



Source: JLL

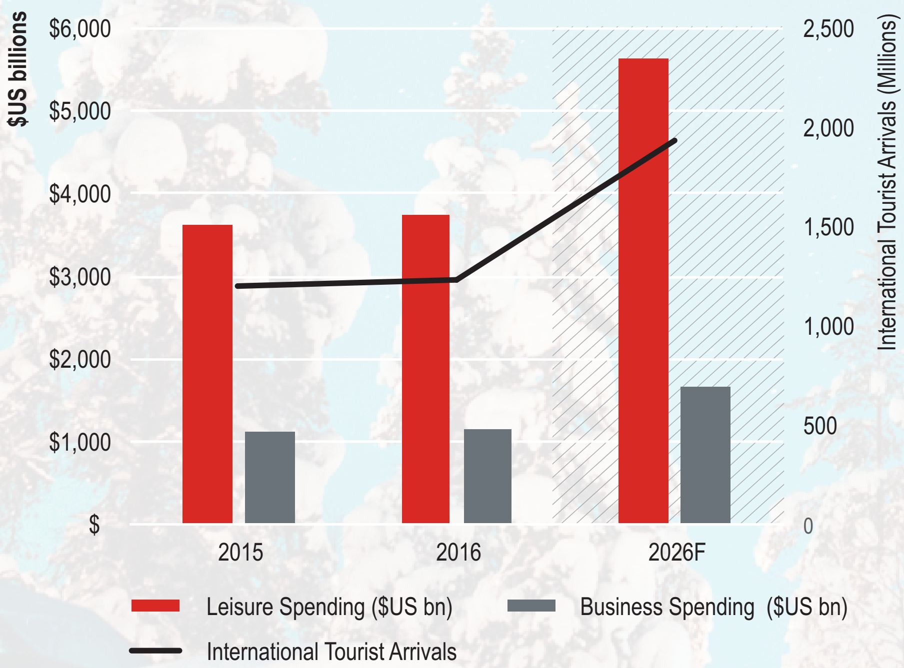
International travel on solid upward trajectory

Despite geo-political issues, terrorism, and economic volatility, the tourism industry has shown resilience and travel remains on the increase. The movement of international travellers is projected to grow 4% annually over the next ten years, resulting in a lot of heads in beds.

International visitors around the globe grew 3% in 2016. Japan, South Korea, Vietnam, Spain, Portugal and Ireland recorded double-digit growth, while major gateways across the U.S. saw record visitor levels in 2016.

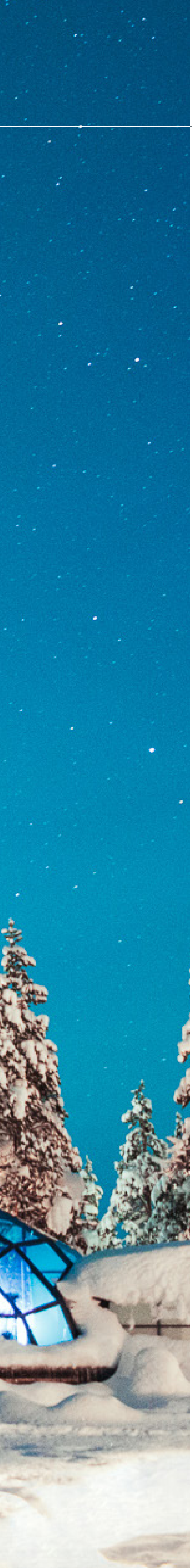
On the other hand, tourist arrivals in France, Belgium and Turkey were impacted due to terrorist attacks.

Global Travel Forecast



Source: WTTC

Kakslauttanen Arctic Resort



Buyer composition to steady in 2017

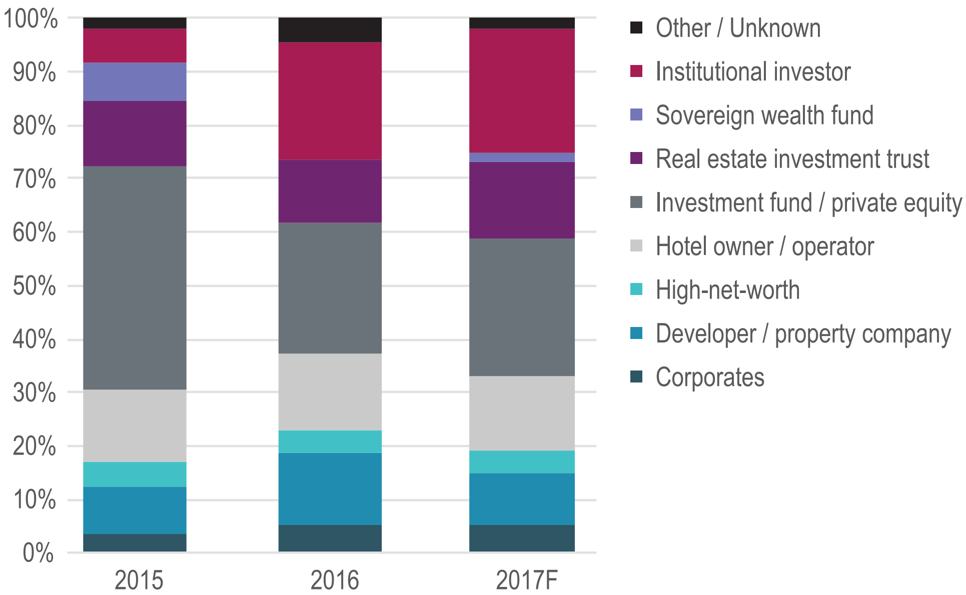
2016 saw big shifts regarding the most active hotel buyers and the composition of buyers became more fragmented. Private equity investors deployed less money in 2016, making way for institutional investors.

Transaction volumes by institutional investors secured 20% of market share, four times the proportion seen in 2015. The share of acquisitions consummated by private equity investors and investment funds decreased from over 40% to 25% in 2016. Private equity funds were also not dramatically active on the sell-side.

Institutional investors' buyer share is expected to stay strong in 2017; private equity buyers stand to see some increases. Particularly in the U.S., a partial re-emergence of private equity investors is on deck, with funds having raised capital to deploy.

The role of private equity is shifting. In some cases, where they did sell big portfolios in 2016, investors are staying in the deals in a partial capacity. They continue to serve as portfolio managers when selling to long-term-hold institutional capital, which has less hotel real estate expertise.

Hotel Buyer Composition



Source: JLL

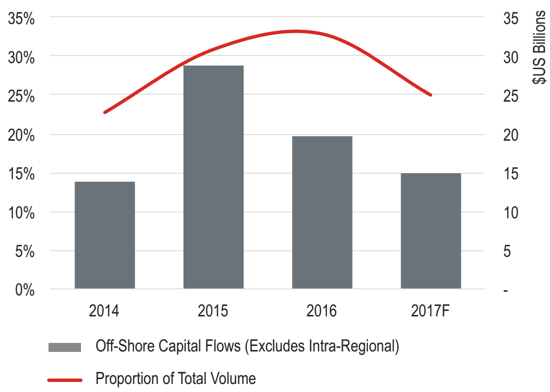
Transaction volumes by institutional investors in 2016 was four times the proportion seen in 2015.

Share of cross-border capital peaks in 2016

The proportion of investments funded by off-shore capital reached an all-time record of 33% in hotel deals. In 2017, with more uncertainty regarding how capital from mainland China will shape up, this proportion is expected to decrease, but remain in line with the recent multi-year average.

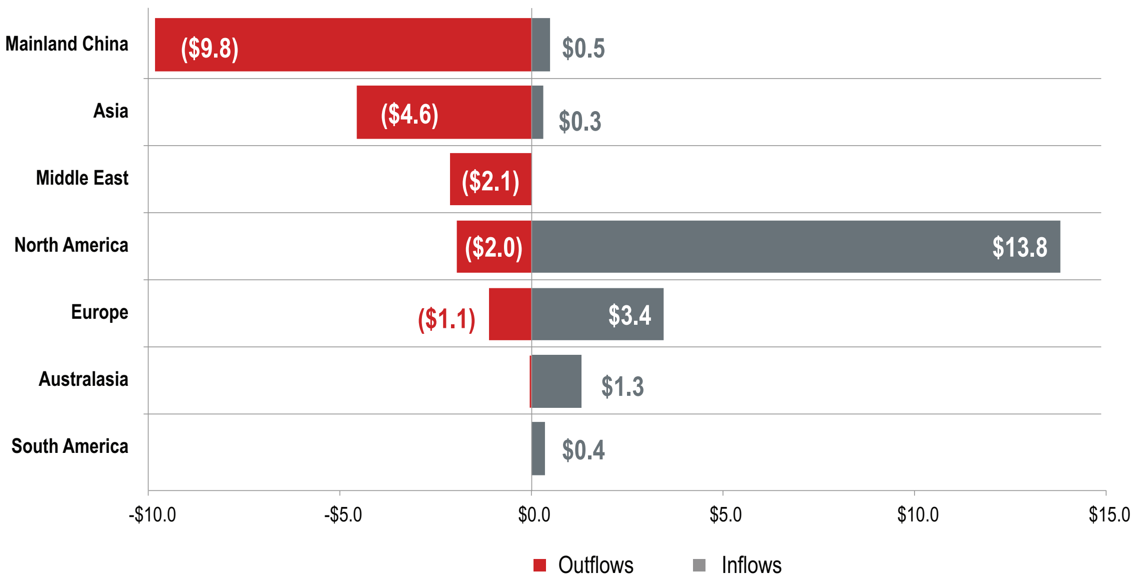
In 2016, North America overtook Europe as the largest destination for inbound capital, attracting nearly $14 billion from overseas investors. As has been much talked about, investors from mainland China were the largest outbound force, followed by other Asian countries.

Off-Shore Activity



Source: JLL

Hotel Transactions: Capital Outflows and Inflows 2016



Figures are in $US Billions

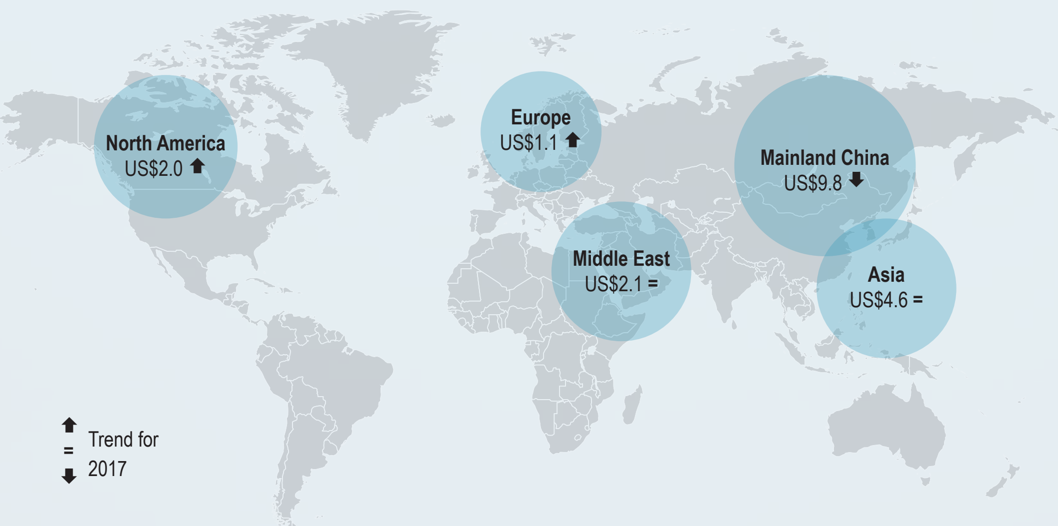
Source: JLL

Capital from the Middle East is down greatly from recent annual averages, due to oil-producing countries' economic woes, and their outbound activity in 2017 is expected to be flat.

American-based private equity funds were largely absent abroad for most of 2016, but started making bolder and more frequent plays in Europe towards the end of 2016. We expect this trend to continue now that some shock surrounding the EU referendum has subsided; Spain will be most favoured but we expect selected plays in the UK as well.

Outbound flows from Europe will continue to rise, driven by institutional investors targeting high-profile leased assets. Investors from Asia (outside of mainland China) will continue to feature, with groups from South Korea and Singapore at the fore. Hong Kong-based buyers with capital connected to China stand to be active as well.

2016 Outbound Volume Capital Flows and Trend for 2017



Figures are in $US Billions
Source: JLL

Photo: Genberg Art UW Ltd by Jesper Anhede

More brand M&A activity on deck

Hotel companies made headlines in 2016, announcing purchases of other parent companies, such as Marriott International's acquisition of Starwood Hotels & Resorts, HNA Tourism Group Co. Ltd's purchase of Carlson Hotels, and HNA Tourism Group Co. Ltd's announced stake acquisition in Hilton Worldwide.

1,000,000

Branded hotel rooms involved in brand and parent company mergers and acquisitions

Note: Pertains to M&A announced by publicly-held or large-scale global companies since 2014

30%

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

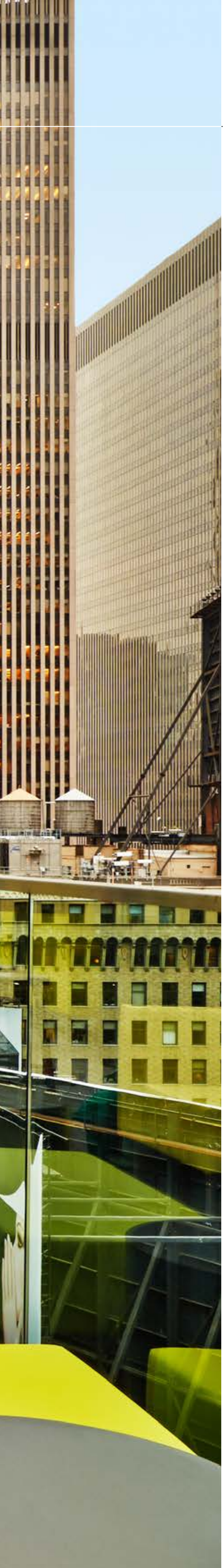
Note: Pertains to hotels positioned in the full service and luxury categories; for part stake purchases, room counts were netted down to proportion that transacted

Hotel acquisitions and mergers announced since 2014 involving a publicly-traded or large-scale global company total nearly one million hotel rooms. The full-service brands that changed ownership at the parent company level represent approximately 30% of all full-service branded rooms globally. This shows just how prevalent ownership changes have been, and little slowdown is in sight.

The case for hotel brand consolidation is that public markets reward growth. Hotel brands are on a never-ending quest to bolster their pipeline. With the natural attrition in properties and limits to new supply growth, the surest way to grow is often by acquiring operators with management and franchise contracts. Equity analysts favour those that have a full range of offerings, in terms of service levels and geography.

Furthermore, with revenue per available room growth slowing across mature markets, brands and management companies are looking to boost EBITDA and boost efficiency by adding properties. We expect to see more consolidation among operators and real estate owners alike due to key players' need to remain competitive through efforts that align growth strategies.

Photo: CitizenM New York



Japan and Australia remain a core focus in Asia Pacific

Two of the most preferred investment markets for 2017 are Japan and Australia, followed by Thailand, Vietnam, Hong Kong, Singapore and the Maldives. In the Indian Ocean, investor interest is expected to go beyond the highly sought-after Maldives with a renewed focus shifting to the Seychelles and Mauritius resort markets.

For Japan and Thailand, there will be good buying opportunities, while stock options remain limited in Australia, Hong Kong and Singapore. Japan in particular will see a continuation of limited-service portfolios and one or two key trophy assets brought to the market. Other markets to keep an eye on include Malaysia, Cambodia and Myanmar, who have seen landmark transactions in 2016 which are expected to prompt more buyer interest this year.

On the negative side, Asia Pacific markets are not immune to threats of terrorism; ongoing travel advisories in some countries are dampening foreign arrivals as well as the crackdown on ‘zero-dollar tours’ affecting Thailand.

As a result of the recent crackdown, Chinese tourist arrivals to Thailand in the last quarter of 2016 dropped by more than 12% compared to the year prior, and this is expected to continue into 2017. A slowdown of economic growth and a new world order of, perhaps, a more confrontational association with the U.S. when it comes to trade are creating uncertainty as to China’s economic growth prospects.

Australia’s overdue supply wave will commence in 2017. New stock is certain to place pressure on room rates in Brisbane and Perth. However, in Sydney and Melbourne, where occupancies have neared the 90% mark in 2016, expectations are for the new supply to be more than matched by tourism demand.

Tier 1 cities in Australasia will dominate. More specifically, we anticipate Sydney’s robust fundamentals will see elevated activity in both the churn of existing hotels and new-build opportunities, while Auckland will start to see opportunities for new supply within three to five years. Queensland leisure markets such as Cairns and the Gold Coast are in demand as airline capacity and the low Australian dollar stimulate domestic and inbound travel, which has translated into solid trading performance.

Two of the most preferred investment markets for 2017 are Japan and Australia.

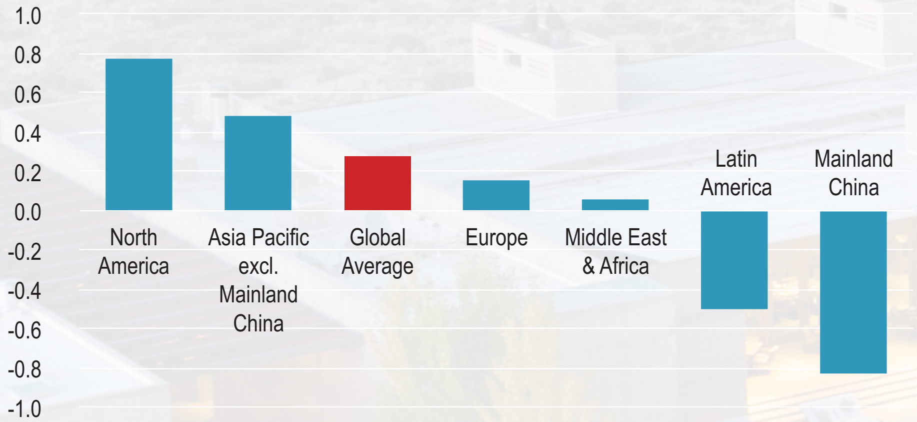
Supply pipeline momentum shifting

The heady hotel supply pipeline in markets like China has been much talked about. Demand and supply dynamics are starting to move more in sync, with China seeing a decrease in the share of rooms under construction as a proportion of existing rooms from last year.

Latin America is posting a slowdown as well. On the other end of the spectrum, the supply pipeline in North America is facing upward momentum, with the same being the case for Asia Pacific markets outside of mainland China.

Supply Pipeline Momentum

Rooms Under Construction 2016 vs. 2015 as % of Existing Rooms, Percentage Point Variance



Source: JLL, Government Statistics Bureaus, STR

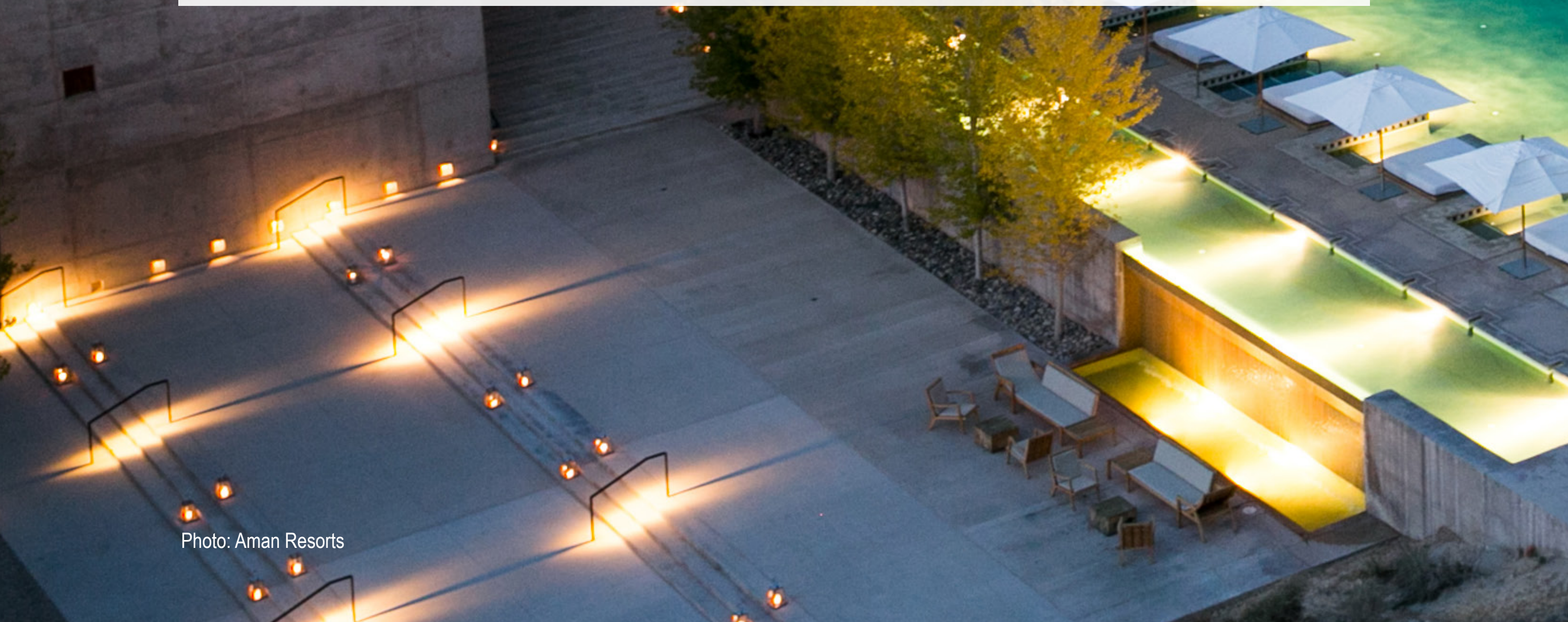


Photo: Aman Resorts

Where next for Chinese investors?

A lot of questions surround the role of capital coming out of mainland China in 2017. While the Chinese government recently announced significantly tighter measures on outbound capital in mid-December for "non-core" business activities, interest from mainland Chinese investors is not expected to grind to a halt.

Chinese capital continues to look for trophy assets in preeminent global markets like London, New York, Paris, Hong Kong, Singapore, Tokyo and Sydney. Since 2015, investors based in China have branched out into portfolio hotel real estate plays that have extended to large hotel real estate portfolios.

Investment prospects remain favourable for Chinese investors. With the potential weakening of the renminbi, transactions in the U.S. and Europe, with a 7% return, remain attractive.

Even at low leverage levels, Chinese investors are able to realize returns of 15%, which exceed those seen at many investments at home. That said, due to tighter capital controls, a number of transactions pursued by Chinese buyers will go on hold, especially those over $1 billion.

With the potential weakening of the renminbi, transactions in the U.S. and Europe, with a 7% return, remain attractive.

Growth becomes more uneven in the U.S.

Hotel occupancy in the U.S. reached a new record in 2016, despite increases in supply, suggesting just how robust the market remains. That said, growth has become more uneven, and a handful of major markets such as Houston, Miami and New York have seen growth turn negative. In 2017, the strongest performers will be secondary markets along with west coast markets and Washington, D.C.

It seems a distant memory when public REITs represented a significant buyer share, but a comeback is likely and the impact of REITs' activity will be driven by the extent to which their share prices rally.

The U.S. has shown signs of economic optimism following Donald Trump's victory in the presidential election. The business community generally expects the administration to involve business-friendly policies, like lower tax rates and large infrastructure projects to stimulate economic growth, which could stand to benefit the hospitality industry.

Investors expect cap rates to mark a slight increase in 2017, driven by slowing hotel income growth and interest rate increases. But the market's size and liquidity will make the country a top target for investors.

Canada is slated to outperform the U.S. slightly in terms of hotel income growth due to lower new hotel additions; Canadian hotels are maintaining good pricing power. Toronto, Vancouver and Montreal are performing exceptionally well and this trend is expected to continue amid a continued weak Canadian dollar which is underpinning tourism. On the flip side, Alberta continues to struggle and that trend will be slow to reverse unless there is a material increase in oil prices.

Mexico has generally remained a standout, but the country's economic outlook now faces more pressure, partly in response to the new administration north of the border. Leisure demand for resort markets, however, should remain strong, as U.S. consumer sentiment is strong.

The outlook for South America continues to be challenging. The region's major economies continue to grapple with depressed commodity and oil prices, currency devaluation, fall-out from corruption allegations, escalating inflation and the adverse effects of purposefully enacted economic austerity measures.

Growth of supply is generally outpacing that of demand, putting market performance under pressure. Although economists are predicting lacklustre economic growth for most countries in South America, the overall sentiment is that the worst is behind us and a moderate economic recovery is in order.

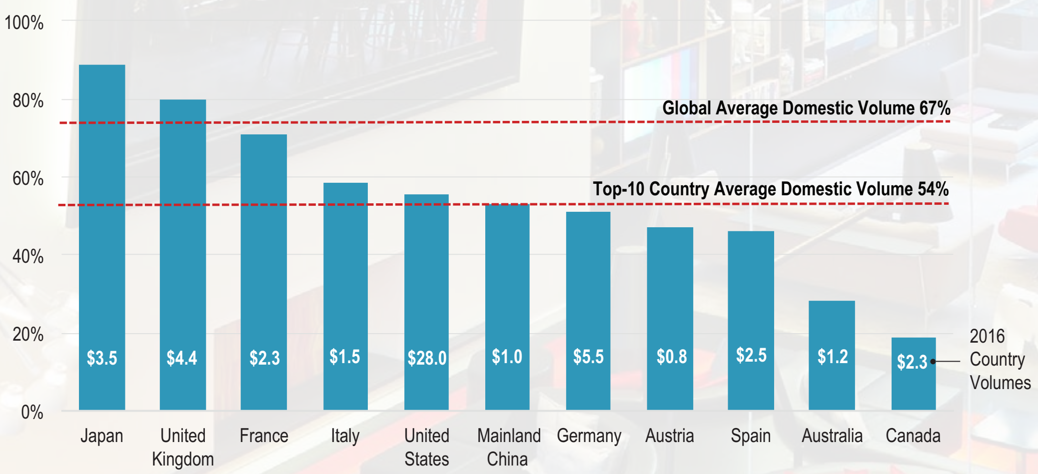
Home investors set to dominate the U.S.

To project the amount of capital targeting hotel investments in 2017, it helps to examine the source of funds that are driving transactions. Japan typically sees among the most domestic composition of buyers, making the market less reliant on outside forces.

The UK became dramatically more domestic in 2016 as foreign investors slowed their sights on the country, but this trend is expected to reverse gradually.

The U.S., on the other hand, saw a record proportion of off-shore capital in 2016. But 2017 stands to be the year of the domestic investor in the U.S., driven by an increase in buys from private equity funds and REITs, while investment flows from major recent buyer groups, such as mainland Chinese investors, slow.

10 Most Active Countries 2016 - Acquisitions by Domestic Buyers



Source: JLL

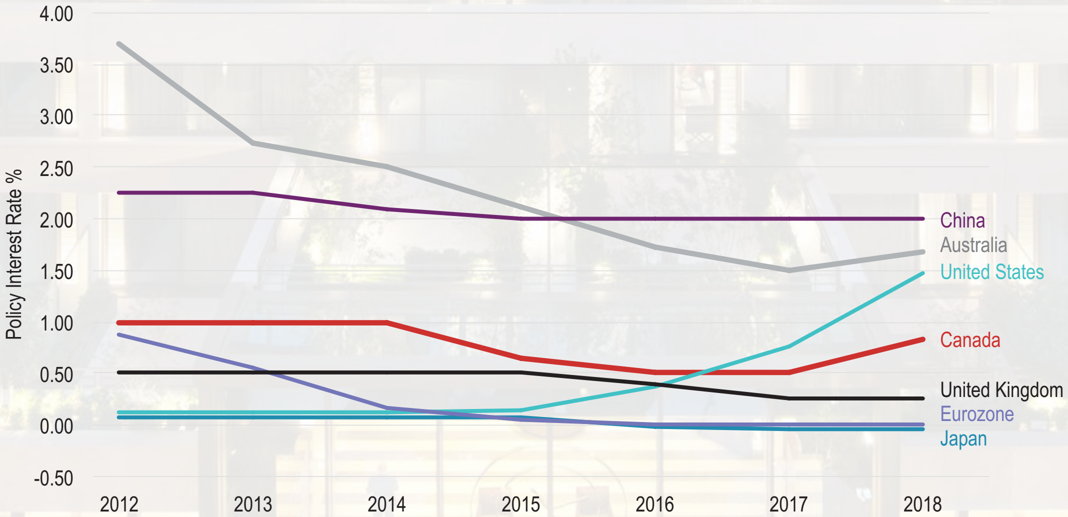
Photo: CitizenM New York

Buyers pricing in gradual interest rate increases

The U.S. Federal Reserve's gradual interest rate increases mark a new era in global monetary policy. But when the Fed took its first step, the market expected it and the first gradual upticks have already been priced into investments.

While the rest of the world is still lagging, other key economies will consider similar step-ups in 2017 and beyond. That said, the overall interest rate environment is expected to remain benign and rates' impact on asset pricing should largely remain minimal. Investors are not expected to alter major investment decisions as a result.

Major Economies' Policy Interest Rates



Source: Oxford Economics, Central Banks

> *While monetary policy will shape investors' attitudes, it should not shape their strategies.*

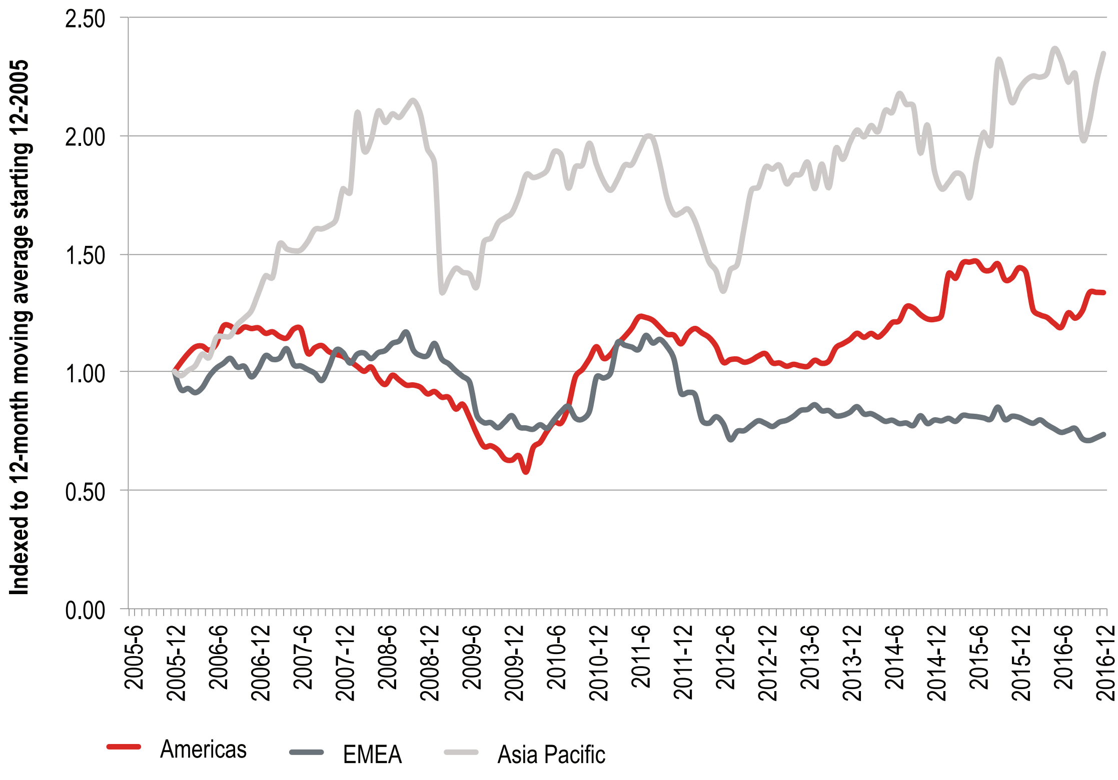
Photo: Mandarin Oriental, Paris

Values across the U.S. to soften; Europe may see some upside

Values stand to soften across North America as hotel income growth slows and interest rates tick up gradually. But investors are already accounting for these forces, which resulted in cap rate increases of approximately 30 basis points in 2016. Cap rates are expected to see some upward pressure in 2017.

Across Europe, we expect yields to mark further sharpening across a number of markets such as Germany and Spain, while UK markets are due to see some upward pressure with regard to cap rates. On balance, European transaction values are below the previous peak from ten years ago, suggesting that pricing has more runway to grow than across North America.

Single-Asset Per-Room Hotel Transaction Value Index



Source: JLL

Hotel valuations across Asia Pacific have generally eclipsed the previous peak levels seen before the global economic downturn—in part because the region did not fall as deeply. The trend line for Asia Pacific is more volatile due to the lower transaction volume overall.

Europe expected to fare better despite heavy election year

Europe is coming out of a challenging year with regard to real estate investment. First and foremost, investors became cautious in the lead up to the EU referendum, taking a 'wait and see' approach. A series of terrorist attacks hurt a number of top tourist destinations and the continued unpredictability of threats has kept some foreign travellers away.

Despite this, most markets in Europe actually reported RevPAR growth during 2016, with countries like Portugal and Spain benefiting from displaced travellers who may have otherwise visited France, for instance.

Europe saw the most protracted slowdown in investment volumes in 2016. Germany overtook the United Kingdom as the second most liquid global market, securing $5.5 billion of hotel deals. The United Kingdom itself reported a 73% decline in hotel transaction volumes, closing the year with $4.4 billion of hotel deals in the bag, much of it attributed to a decline in portfolio transactions.

While London remains in the top spot of desired investment destinations, the lack of available product for sale and the gap between buyer and seller expectations has drawn investors to key regional UK markets. This is evident through the increase in transaction activity in Birmingham and Manchester. In addition, hotel transactions in Ireland rose 73% year-on-year to $776 million in 2016.

In 2017, we expect Europe to see the most significant improvement of all global regions. Favourites will include Spain, Ireland and Portugal. Germany will also remain active, notwithstanding our expectation for a minor decrease in investment volumes following a record 2016.

Major economies scheduled to hold elections in 2017 include Germany, France and the Netherlands. As the outcome of these is determined throughout the year, we expect investment volumes to gradually intensify.

Hotel owners' expectations have reset and there's an increasing proportion who want to sell now, as many markets are still expected to see a sharpening of yields, as opposed to waiting for one or two more years when hotel performance might plateau.

In 2017, we expect Europe to see the most significant improvement of all global regions. Favourites will include Spain, Ireland and Portugal

Photo: Solent Forts' Image Spitbank Fort - From the Air

The changing dialogue about alternative accommodations

Lodging companies and hotel real estate investors have typically not been at the forefront of technology investment and disruptors have entered the market loudly.

While the bread and butter of the industry, namely the business of accommodating guests in hotel rooms, remains largely intact, new players have entered the foray in meaningful ways, with one of the most notable business models being home-sharing sites such as Airbnb and Homeaway.

Disruption from home rental sites and alternative accommodations remains relatively small in the grand scheme of the global lodging sector. Home rental sites and the alternative accommodations market account for approximately 10% of hotel room bookings in the top global gateway markets such as New York, London and Paris, according to calculations by JLL.

Alternative accommodations have notable runway for growth in secondary and tertiary markets, but our research suggests that the number of room nights accommodated by such platforms is already plateauing in urban gateway markets; in part due to the number of willing hosts reaching a structural ceiling. The dialogue is also expanding notably from home-sharing sites' impact on the hotel market to the business model's impact on residential markets—in particular rental units.

Our research has found that demand stimulated by such alternative accommodations primarily tends to take share from lower-tier hotels, but that a significant portion of the demand, often as much as 30% to 50%, is induced to the market, meaning that those visitors would not have made the trip had it not been for what is often a lower-priced option.

All eyes are on home sharing sites' aim to accommodate more business travellers. Given the prominence and prevalence of new ideas in the technology world, we expect to see more and more creative partnerships going forward. While there is risk and trial and error involved, we believe some of the most interesting matchups will be where hotel companies partner with these newer entrants—an example being AccorHotels' acquisition of Onefinestay for a reported $170 million in 2016.

> *The alternative accommodations market accounts for approximately 10% of hotel room bookings in the top global gateway markets.*

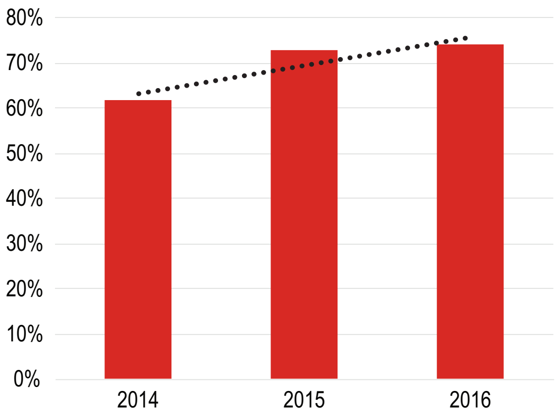
Photo: Zoku, Amsterdam

Can single-focused, specialist hotel investors stay in the game?

An ever-growing share of hotels is being acquired by groups whose holdings and business span beyond hotel real estate. In 2016, a record 72% of deals over the $50 million mark was purchased by such generalist investors.

Specialist investors—groups that invest solely in hotels, are a decreasing force in the buyer pool and represent a relatively fragmented group, spanning those who own just a handful of hotels to large public REITs with 100+ hotels.

Share of Hotel Real Estate Purchases by Generalist Investors



Note: Pertains to transactions US$ 50M+. Generalist Investors are defined as investors who also invest in other asset types or investments, beyond having a singular focus on hotel real estate
Source: JLL

Over the long-term, specialist investors are less likely to exist in their current form. We expect a notable proportion to be absorbed by private equity funds and institutional investors, taking advantage of former specialists' hotel acquisitions and asset management expertise. As such, share of purchases by generalist investors is expected to increase during the next several years.

Contacts:

Mark Wynne Smith
Global CEO
Mark.Wynne-Smith@eu.jll.com

Jessica Jahns
Head of Research, EMEA
Jessica.Jahns@eu.jll.com

Lauro Ferroni
Global Head of Hotels Research
Lauro.Ferroni@am.jll.com

Frank Sorgiovanni
Head of Research, Asia Pacific
Frank.Sorgiovanni@ap.jll.com

Geraldine Guichardo
Head of Research, Americas
Geraldine.Guichardo@am.jll.com

To learn more about hotel investment outlook visit our website:
www.jll.com/hio

Cover photo: Treehotel by Johan Jansson