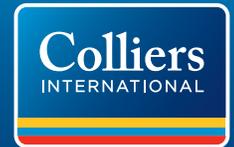


HAWAII YEAR-END 2014

# INVESTMENT MARKET REPORT



## Record Sales Volume for 2014!

Commercial real estate sales volume in Hawaii achieved a new record high when more than \$4.57 billion worth of properties traded hands in 2014. This is a healthy 25% jump in dollar volume from 2013 levels and is the third consecutive year of increased sales. An estimated 265 commercial real estate transactions (priced above \$1 million) were recorded for the year as transaction flow returned to levels not experienced since the last boom period from 2004 to 2007.

Hawaii generated increased interest from institutional and international investors who spent a total of \$3.8 billion on commercial real estate in 2014, with the average transaction size at roughly \$46 million. When compared to the average transaction size of a local investor at \$4.12 million, there is a marked difference in the size and scope of investment property targeted by the two types of investors. While institutional investors typically prefer top tier investment properties, local investors appeared to favor smaller, lower priced multifamily and industrial warehouse properties.

### MARKET INSIGHT

“Record investment sales volume indicates that institutional investors are scouring tertiary markets like Hawaii with hopes of avoiding heightened competition faced in other markets.”

Scott L. Mitchell (B) SIOR

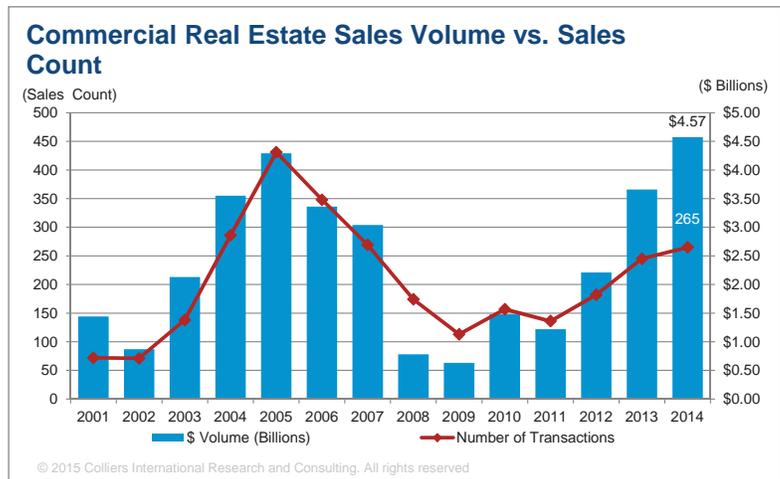
### MARKET INDICATORS (OVER PRIOR YEAR)

	YEAR END	
	2013	2014
SALES VOLUME	↑	↑
SALES COUNT	↑	↑
CAP RATES	↓	↓

### HAWAII HIGHLIGHTS

YEAR END 2014  
\$1M+ COMMERCIAL INVESTMENT  
NUMBER OF TRANSACTIONS 265

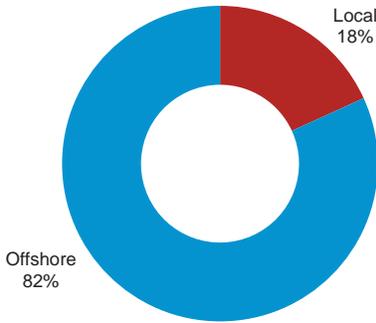
YEAR END 2014  
\$1M+ COMMERCIAL INVESTMENT  
SALES VOLUME \$4.57 Billion



YEAR-END 2014 SALES SUMMARY					SALES COUNT		SALES VOLUME	
Property Type	Sales Volume	Sales Count	% of \$ Volume	% of Sales Count	Local Investor	Offshore Investor	Local Investor	Offshore Investor
Multifamily	\$463,052,004	76	10.12%	29%	71	5	\$162,442,004	\$300,610,000
Hotel/Resort/Golf	\$1,686,341,219	20	36.87%	8%	5	15	\$96,182,170	\$1,590,159,049
Industrial	\$212,146,878	40	4.64%	15%	33	7	\$134,609,975	\$77,536,903
Office	\$186,868,625	21	4.09%	8%	14	7	\$123,441,139	\$63,427,486
Land	\$611,924,121	64	13.38%	24%	34	30	\$192,481,884	\$419,442,237
Retail	\$1,413,884,582	44	30.91%	17%	26	18	\$122,390,423	\$1,291,494,158
	<b>\$4,574,217,428</b>	<b>265</b>			<b>183</b>	<b>82</b>	<b>\$831,547,595</b>	<b>\$3,742,669,833</b>

Source: Real Capital Analytics, Hawaii Information Service, Colliers International

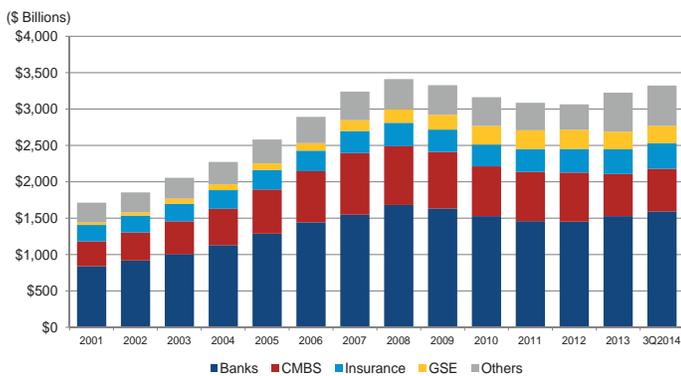
### Sales Volume by Buyer Location



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In a typical year, hotels garner the lion's share of the investment dollar volume. While the \$1.7 billion spent on hotel acquisitions marks the second year of elevated activity for this property sector, the jump in retail transactions set a new record at \$1.4 billion. A major contributor to this boost was the sale of Royal Hawaiian Center to JP Morgan which was the largest real estate transaction for the year. The leasehold sale generated \$697 million in endowment capital for landowner Kamehameha Schools.

### Outstanding Real Estate Mortgage Debt by Source

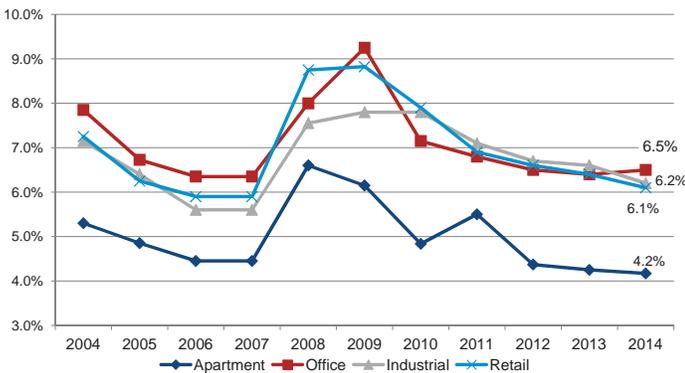


Source: PREA, Federal Reserve

The elevated sales activity is representative of the national boom in commercial real estate sales which eclipsed \$423 billion in 2014. Investment capital is flowing back into real estate as the number of outstanding mortgages has steadily risen to \$3.23 trillion at the end of the third quarter of 2014, surpassing the levels established in 2007. Nearly all mortgage funding sources, including banks, pension plans and the CMBS market boosted loan placements over the past year.

Loan performance has improved dramatically as banks report that delinquency rates have continued to fall. At mid-year 2014, loan delinquencies for banks fell to 1.8%, a marked drop from the 8.8% reported at the height of the last recession. Similarly, CMBS loan delinquencies declined from a peak of 8.5% down to 3.9% currently. The availability of capital at low interest rates is helping to reduce loan delinquencies and prevent defaults as borrowers are better able to refinance their outstanding debt.

### Hawaii CRE Estimated Capitalization Rates



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The increase in volatility in global markets for foreign currency and bonds is also stroking the demand for U.S. real estate investment. While many Asian and European economies are facing recessionary fears and currency depreciation, the U.S. market is poised for healthy growth and a strengthening dollar. With rental rate growth and property appreciation anticipated for the U.S., foreign capital seeking a safe haven will continue to expand their U.S. holdings.

As fixed income investments such as treasury bills, money market funds and bonds continue to generate historically low returns, investors are looking at real estate as an alternative investment option. The National Association of Real Estate Investment Trusts (NAREIT) reported that REITs experienced a 26.44% return for 2014, outpacing those provided by S&P 500, NASDAQ, and Russell 2000 indexes.

As demand for real estate pushes prices upward, capitalization rates get further compressed. This trend is also evident in Hawaii, where a majority of prime real estate is priced within the 6.0% to 6.5% cap rate range. The recent volatility in the stock and bond markets coupled with extremely low money market rates make real estate yields very appealing to investors.

## Hotel Investment Activity Remains Elevated

Hotels continue to remain a prime investment target in Hawaii for both institutional and international investors. In 2014, nearly \$1.7 billion of hotels and golf courses in Hawaii was sold. Of the 3,300 total hotel rooms sold, the average price per room was \$376,859. This continued healthy demand for hotel investments has led to average hotel cap rates falling to 5.2% for 2014.

Hawaii's hotel market continues to post healthy market fundamentals as air passenger arrival counts reached a record \$8.3 million for 2014 for a 1.3% gain over 2013 levels. While the Japanese market posted a decline in arrival counts and visitor spending, these losses were supplanted by the improvement of both the U.S. domestic and international markets (Asia, Oceania and Europe) as visitor expenditures rose to a record \$14.7 billion.

Hotel performance metrics improved over the past year when the statewide average daily room rate rose to \$241, and revenue per available room jumped to \$188, for a gain of 4.9% and 4.8% respectively. Hawaii's hotel occupancy rates remained among the top nationwide, with an average of 77.8%.

While oceanfront resort development remains difficult due to the lack of potential waterfront sites, the recent planning commission approval to include hotel development on previously zoned B-2 (Business Community) and BMX (Business Mixed Use) land is attracting increased developer interest. Hotel development activity is picking

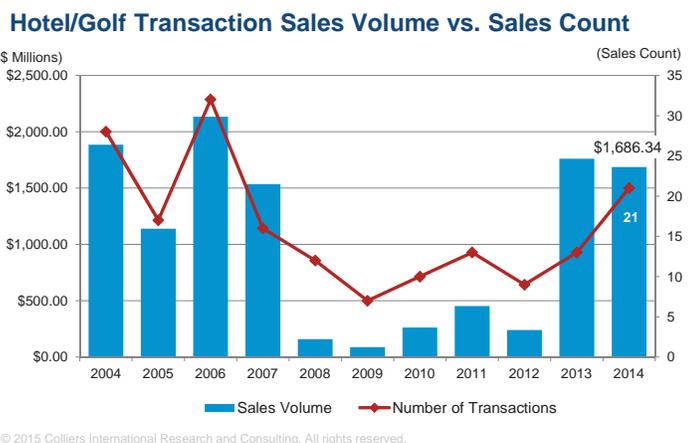
up as ten properties are in various stages of planning. Many of these hotel projects are being considered in conjunction with larger retail, residential and mixed use developments.

## Global Brands

Until recently, only the large, upscale oceanfront resorts in Hawaii were branded with full-service global brands. The remaining hotels were either local brands or unbranded, owner-managed properties. About six years ago the tide changed and global, limited service brands appeared in mass. Marriott added four Courtyard-branded hotels in Waikiki, Kauai, Kona and Maui. Outrigger put the Embassy Suites flag on a hotel they redeveloped on Beachwalk and a Holiday Inn flag on the Beachcomber. A Hyatt Place flag went up in Waikiki in 2011 and a Hilton Garden Inn is planned for the Ohana West redevelopment. New or proposed brands for Hawaii include Courtyard, Hilton Garden Inn, Hampton Inn, Hyatt Place and Embassy Suites.

## Foreign Money Seeks Placement

The recent acquisition by billionaire Chanchai Ruayrungruang of 1,100 acres of land on Kauai, and the Princeville Golf Course, marked the largest Chinese investment in Hawaii in several decades. Japan-based Resorttrust Inc.'s acquisition of the Kahala Hotel for \$282.5 million marks the return of Japanese investment in Hawaii's prime hotel properties. Anecdotally, brokers are mentioning they are seeing an increased interest by foreign investors in Hawaii's hotel properties.



Hotel Metrics		
Year-End 2014	Statewide	% Increase over Year-End 2013
Occupancy	77.80%	Nominal
Average Daily Room Rate	\$241.28	4.9%
Revenue per Available Room	\$187.72	4.8%
Visitor Spending	\$14.7 Billion	2.2%
Air Passenger Arrivals	\$8.3 million	0.9%

Source: Hospitality Advisors LLC

## Multifamily Remains Most Popular Investment Target

Competition is fierce among small investors seeking to enter the commercial real estate market through the purchase of multifamily properties. A total of 76 multifamily properties traded hands during the year, comprising 29% of the total 265 transactions. While other property types were dominated by offshore institutional investors, 92% of the multifamily properties were acquired by local entities. Cap rates remain compressed as bidders push up prices for the few apartment buildings on the market for sale. Multiple multifamily properties have been acquired at or below the 4% cap rate level.

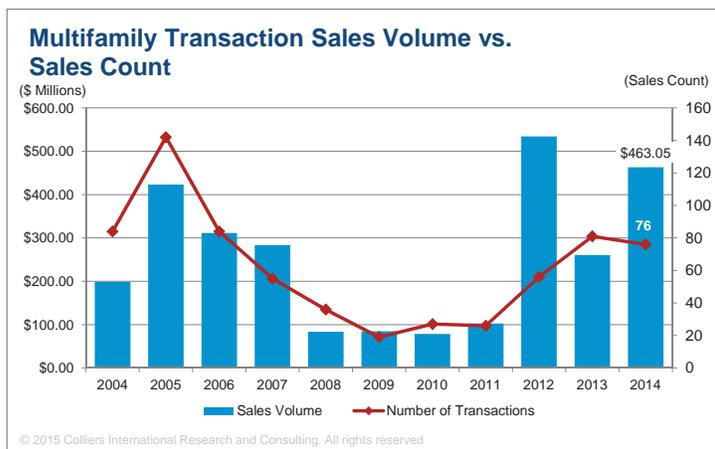
With interest rates for 30-year mortgages in the 3.5% range, investors are facing very thin investment returns. Many are aggressively hoping for property appreciation and rising rents to fuel higher yields. According to the State of Hawaii Rental Housing study conducted by Ricky Cassidy, the statewide average of rent for a two-bedroom apartment was \$1,977 per month, a healthy 6.6% increase from last year.

Multifamily investment transactions rose to \$463 million, the second highest level over the past thirteen years. The combined \$300 million sale of the Waena Apartments and Kalaeloa Rental Homes portfolio by Carmel Partners to Douglas Emmett and Rockpoint Group, contributed to the boost in multifamily sales activity.

Both State and City governments have lamented the shortage of rental housing and have alluded to a 10,000 unit shortfall in the latest State of Hawaii housing study. The City Council of Honolulu recently announced exploring the possibility of using shipping containers as rental housing. Vacancy rates are believed to be below 5% for available rental apartments. In a recent poll, Hawaii residents identified the need for affordable housing as one of the primary problems facing the state. Current market conditions fuel further investor demand to buy multifamily properties in Hawaii.

While development has principally been limited to workforce and affordable government sponsored rental housing projects, Forest City and Avalon Development have proceeded to move forward on their market rate rental housing projects located in Kapolei and Hawaii Kai. Both developers feel confident that there is a level of market demand to support their market rate residential rental projects.

As median prices for single family homes and condominiums surpassed historic highs, affordability becomes a major impediment for a vast majority of potential home buyers. The combination of a severe shortage of workforce housing, rising home prices and a planned interest rate increase in 2015, will further enhance the demand by investors for rental housing acquisition opportunities.



### Residential Metrics

Year-End 2014	Oahu	Maui	Big Island	Kauai
Median Single Family Home Price	\$690,000	\$565,000	\$338,000	\$875,000
Single Family Home Sales Count	3,285	963	1,831	462
Median Condominium Price	\$361,250	\$387,500	\$243,500	\$400,000
Condominium Sales Count	\$4,810	\$1,199	\$633	\$317

Source: DBEDT

## Retail Portfolio Divestiture Drives Sales Volume

The plans by Kamehameha Schools, one of the largest owners of retail shopping centers in the State of Hawaii, to divest itself of the leasehold interest in their major shopping centers provided the impetus for the spike in retail investment activity for 2014. The sale of both Royal Hawaiian Center and Hawaii Kai Towne Center generated more than \$806 million of the total \$1.4 billion spent on retail centers throughout the state.

Institutional investors spent more than \$1.3 billion, or roughly 91% of the total \$1.4 billion of overall retail investment sales, on Hawaii's retail centers in 2014. Local investors acquired 26 shopping centers or 59% of the total count of retail centers sold. Average retail capitalization rates continued to compress, falling to 6.1% from 8.8% over the past five years.

Hawaii's economy continued to improve after posting solid job gains and a resultant decline in the state's unemployment rate. While home sales remained muted

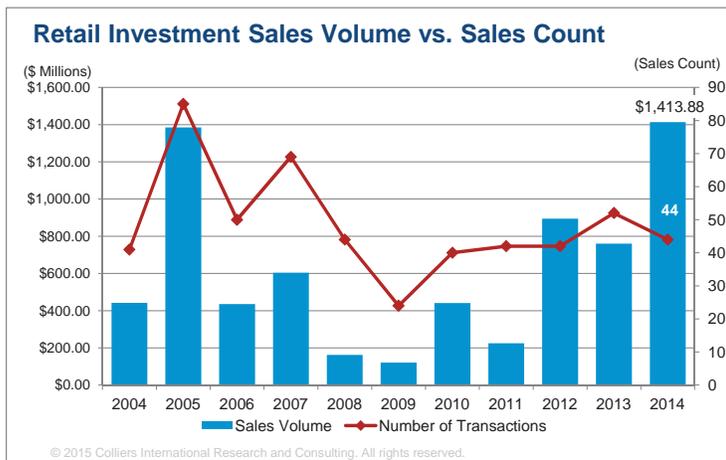
due to a lack of available supply, the median home price rose to a record \$719,500 in November 2014. Retail sales established a new record, jumping 9.4% over prior year, to \$9.96 billion (2014 October year-to-date).

The retail market faced some volatility at the beginning of the year after the closure of discount retailer, Price Busters (90,000 square feet). By year-end, vacancy rates stabilized and actually posted 12,972 square feet of positive absorption at year-end 2014. At these tight market conditions, average asking base rents began to spike and generated a 12.3% jump over 2013 levels.

## Development Boom

Development activity on Oahu is increasing with plans for nearly 2.0 million square feet of retail space concentrated within DeBartolo's Ka Makana Alii Kapolei regional mall, Robertson Properties' Aiea Kamehameha Drive-In mixed-use project, General Growth's Ala Moana Center expansion, and Taubman's Waikiki International Marketplace redevelopment. Low vacancy rates will likely persist through 2015 and until these planned developments are delivered sometime between 2016 and 2017.

Currently, tight market conditions and increasing rents provide the basis for development plans moving forward. While all the aforementioned projects are unique to their geographic areas and should provide retailers with the needed expansion opportunities, the hope is that each project's pre-leasing activity remains healthy and tenant demand remains strong.



Retail Metrics				
Year-End 2014	Oahu	Maui	Big Island	Kauai
Vacancy	4.09%	10.24%	9.56%	16.49%
Net Absorption	12,972	(5,133)	(39,150)	11,859
Avg. Asking Base Rent (psf/mo)	\$3.64	\$3.16	\$3.54	\$3.27
October YTD Retail Sales	\$22.83 Billion	\$1.55 Billion	\$1.2 billion	\$464.5 million

Source: Department of Taxation, Colliers International

## Soft Conditions Dictate Office Investment Activity

Among the various commercial real estate property types, the office sector is the weakest performer. Oahu vacancy rates steadily increased and currently reside above 13%. This is the result of roughly 800,000 square feet in occupancy being lost since 2007. The neighbor island office market conditions are even worse, with vacancy rates on Big Island, Maui and Kauai all above 14% at year-end 2014. Rental rates have remained fairly flat except for a select few office submarkets.

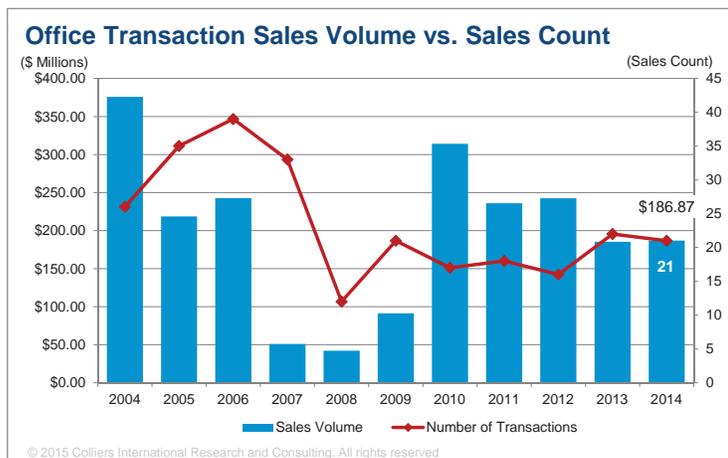
Of the office properties that sold in 2014, the largest was the sale of the Kamehameha Schools ground lease at Executive Center to the AOA for roughly \$75 million. This was followed by Atalanta Realty's acquisition of the former Haseko and Oceanview Buildings for \$22.7 million. Several smaller properties that had faced problematic loan situations were placed up for auction. One King Street and the Hawaii Agricultural Research Center were taken by lenders and sold.

Nationally, a majority of office markets have fully recovered and are posting steady rental rate increases. San Francisco, San Jose, Seattle and Raleigh Durham

are benefiting from the surge in technology sector job growth. Houston, Dallas and Denver, whose office market had benefited from the boom in energy several years ago, are being impacted by the recent drop in oil prices. While Hawaii does not have a large technology industry, the recent decline in solar photo voltaic system installations has resulted in a reduction in both workforce and building permit volume, impacting the amount of office space this sector uses.

Despite soft market conditions and slow office investment activity, economic conditions appear to be steadily improving. The professional business services job category, which is the primary driver of office demand in Hawaii, has posted its fourth consecutive year of job growth. During this time period, an estimate 12,500 jobs were created. This steady growth in jobs should eventually influence office market performance.

Colliers is predicting 2015 to be the year the office market posts positive growth. On Oahu, suburban submarkets remain healthier than the urban core. Dropping vacancy rates in East Oahu, Leeward Oahu and Windward Oahu have led to healthy rental rate increases which helped to boost the island-wide average asking base rent from \$1.57 psf/mo to \$1.64 psf/mo over the past year. But, it will be quite awhile before new office development becomes financially feasible and rental rates justify any major speculative construction.



Office Metrics				
Year-End 2014	Oahu	Maui	Big Island	Kauai
Vacancy	13.15%	16.94%	16.50%	14.34%
Net Absorption	(77,711)	(6,538)	20,240	(18,724)
Avg. Asking Base Rent (psf/mo)	\$1.64	\$1.66	\$1.46	\$1.80
Professional Business Services Job Count	65,400	7,900	7,500	3,300
Unemployment Rate	3.4%	3.8%	4.7%	4.3%

Source: DBEDT/Colliers International.

# Rental Rate Spike Anticipated for Industrial Market

Warehouse properties posted a spike in investment sales activity for 2014, as sales volume surpassed \$200 million for the first time in nine years. Low interest rates and a shortage of available warehouse space for lease have prompted many businesses to consider purchasing their own warehouse facilities.

As industrial vacancy rates near historic lows, warehouse tenants are finding it increasingly difficult to find expansion or relocation space for their businesses. Rents have spiked 12% over the past year, posting a \$1.10 psf/mo average asking base rent for Oahu where vacancy rates have fallen to 2.12% at year-end 2014. Similarly, neighbor island industrial markets reported low vacancy rates with Maui posting a 2.42% rate, Kauai at 2.25%, and the Big Island at 3.74%. With the tight market conditions, rents have begun to escalate. Maui industrial rents generated a statewide high of \$1.17 psf/mo.

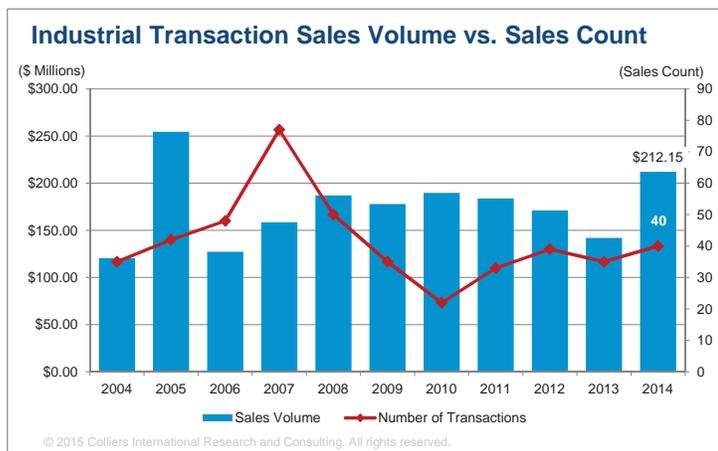
The most notable warehouse transactions included the sale of Kakaako Commerce Center to A&B Properties, Inc. for \$39 million and the acquisition of Kapolei Trade Center by AG Metric KTC Owner LLC for \$34.76 million.

For business owners attempting to stabilize their occupancy costs, increasing consideration is given to buying land and building their own warehouse. Currently, there is a severe lack of developable industrial zoned land in Honolulu's urban core where land values often exceed \$100 per square foot. For businesses willing to commit the resources to building a new facility, land costs can be a major prohibitive factor in moving forward with their plans.

In anticipation of this growing trend, developers are moving forward with their industrial land developments. Avalon Development and Walton Street Capital recently acquired 177 acres of industrial zoned land at Kapolei Business Park Phase II and Kapolei Business Park West for \$84 million. Road and underground utility construction is underway to the first 54 acres; the developer has begun marketing the first 17 lots "for sale" with finished lots being delivered to buyers in the summer of 2015.

The recent release of land for sale at Maui Business Park II is also garnering healthy interest. Parcel sales to Maui County, American Saving Bank and Maui's BMW car dealership recently closed.

The bulk of current industrial land sales are concentrated among businesses planning on using their facilities for their own use. Although current warehouse rents do not yet make speculative warehouse development feasible, current market conditions are likely to drive rents higher. It is highly likely that investors will begin exploring speculative warehouse construction before the end of 2015.



Industrial Metrics				
Year-End 2014	Oahu	Maui	Big Island	Kauai
Vacancy	2.12%	2.42%	3.74%	2.25%
Net Absorption	262,706	(4,187)	N/A	25,085
Avg. Asking Base Rent (psf/mo)	\$1.10	\$1.19	\$0.78	\$0.95
Wholesale Sales (October YTD)	\$12.02 billion	\$400 million	\$448.8 million	\$127.0 million
Building Permit Volume	\$2.07 Billion	\$443.6 million	\$697.1 million	\$102.2 million

Source: DBEDT, Department of Taxation, Colliers International

Notable 2014 Investment Transactions					
Property Type	Property Name	Buyer Name	Seller Name	Sales Price	Sales Date
<b>HOTEL/GOLF</b>					
	Princeville Golf Course and Lands	RW Princeville LandCo LLC	The Resort Group	\$343,000,000	Jul-14
	Wailea Marriott	Sunstone Investors	Blackstone Investment	\$325,500,000	Jul-14
	Kahala Hotel	Resort Trust Hawaii	Trinity Investments	\$282,477,639	Oct-14
	Aston Waikiki Beach	Inland American Lodging Group	Walton Street & Atrium Holdings	\$183,000,000	Mar-14
	Ritz Carlton Kapalua	Colony Capital and Woodridge Capital LLC	Lehman Brothers	\$142,000,000	Feb-14
<b>INDUSTRIAL</b>					
	Kakaako Commerce Center	A&B Properties	Fowler Investments	\$39,000,000	Nov-14
	Kapolei Trade Center	AG-Metric KTC Owner	iStar Financial	\$34,756,931	Sep-14
<b>LAND</b>					
	Kahuaina Planatation and Pilaa	Pila'a International LLC and Kahuaina Holdings LLC	Pflueger Properties/Falko Partners	\$200,000,000	Sep-14
	Kapolei Business Park Phase II and Kapolei West	Walton Street Capital and Avalon Development	Kapolei Properties LLC/Jupiter Holdings LLC	\$84,000,000	Jul-14
<b>MULTIFAMILY</b>					
	Waena Apartments	Douglas Emmett Inc.	Carmel Partners	\$146,000,000	Dec-14
	Kalaeloa Rental Homes Portfolio	Rockpoint Group/Di Napoli Capital Partners	Carmel Partners	\$154,000,000	Dec-14
<b>OFFICE</b>					
	Executive Center	AOAO Exec. Center	Kamehameha Schools	\$74,981,139	Nov-14
	Oceanview Office Building	Atalanta Realty	Morgan Stanley	\$12,312,038	Jun-14
	Haseko Office Building	Atalanta Realty	Morgan Stanley	\$10,437,928	Jun-14
<b>RETAIL</b>					
	Royal Hawaiian Center	JP Morgan	Kamehameha Schools (Leasehold)	\$697,600,000	Jun-14
	Town Center of Mililani	Met Life/M.J. Wilkow	TIAA CREF	\$227,300,000	Dec-14
	Hawaii Kai Towne Center	ValueRock Realty Partners	Kamehameha Schools	\$109,900,000	Nov-14
	Maui Mall	Walton Street Capital	A&B Properties Inc.	\$61,973,878	Jan-14
	International Marketplace	Taubman Development	Queen Emma Land Company (Leasehold)	\$48,000,000	Jan-14

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