Hawaii
Research & Forecast Report

INVESTMENT MARKET REPORT

Second Quarter 2016

Accelerating success.

Investment Sales Volume Slows

Mike Hamasu Director of Research | Hawaii

Global unrest fueled by China's financial market crash, the drop in oil and commodity prices, and Brexit, Britain's successful exit vote from the European Union, rattled investor confidence for the first six months of 2016. According to commercial real estate data analysis firm, Real Capital Analytics, U.S. commercial real estate sale volume fell by 16% to $219.2 billion when compared to last year at this time.

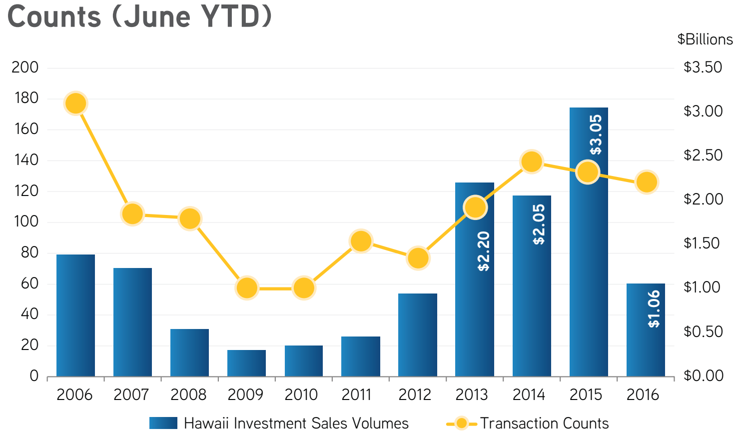
While sales activity is down across the board, tertiary and secondary markets bore the brunt of this decline, having posted a 28% and 15% drop in sales activity, respectively. Top tier metropolitan markets such as New York, Los Angeles, and Boston faced only a slight decline in sales volume of 6% as both institutional and foreign investors were primarily focused on major gateway markets with a lower perceived risk. Nearly all property types generated lower sales volume during this time. The largest declines were in the hotel sector with a 55% decline in sales volume, followed by a 31% drop in industrial property sales.

Hawaii followed similar downward investment sales trends to what happened nationally. Sales volume at midyear fell by 65.3% from last year's midyear record sales volume of $3.05 billion (fractional sales of Ala Moana Center to Australian Super and TIAA-CREF provided a $1.3 billion boost above the norm during the first half of 2015). While midyear 2015 sales figures are likely an anomaly, the $1.06 billion in sales at midyear 2016 is still a sizeable decline from both 2013 and 2014 midyear levels. Fortunately, we anticipate several large transactions will close before year-end and that will likely boost 2016 totals to levels comparable to 2013.

> *"The 10-year treasury yield is hovering around 1.51%. Has there ever been a better time to borrow money to invest in real estate?"*
>
> Guy Kidder (B), Senior Vice President

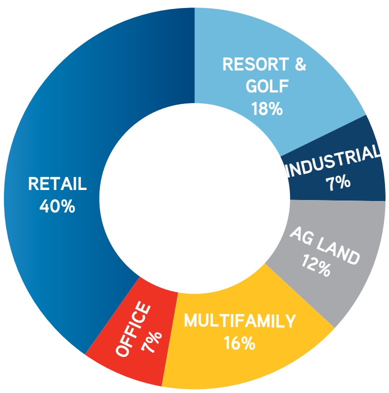
Market Indicators Relative to year-end 2014	2nd Quarter 2016
SALES VOLUME	↓
SALES COUNTS	↓
CAP RATE	↑

Hawaii Investment Sales Volume vs. Transaction Counts (June YTD)

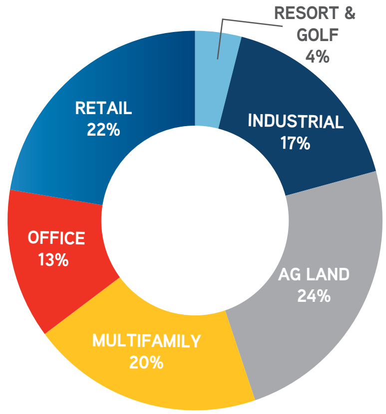


JUNE YTD 2016 SALES SUMMARY			SALES VOLUME		SALES COUNT	
Property Type	**Sales Volume**	**Sales Count**	**Local Investor**	**Offshore Investor**	**Local Investor**	**Offshore Investor**
RESORT/GOLF	$187,816,000	5	$49,850,000	$137,966,000	2	3
INDUSTRIAL	$78,897,693	21	$37,007,693	$41,890,000	18	3
LAND	$123,270,980	30	$57,031,308	$66,239,672	18	12
MULTIFAMILY	$168,074,500	25	$35,674,500	$132,400,000	23	2
OFFICE	$73,786,900	16	$43,721,900	$30,065,000	11	5
RETAIL	$425,514,861	28	$196,755,723	$228,759,138	18	10
TOTAL	**$1,057,360,934**	**125**	**$420,041,124**	**$637,319,810**	**90**	**35**

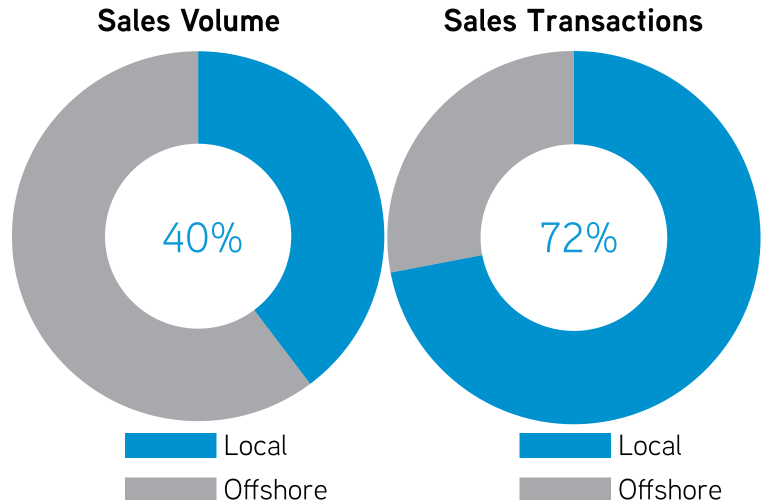
Mid-Year 2016 Investment Percent of Sales Volume



Mid-Year 2016 Investment Percent of Sales Count



Local Vs Offshore



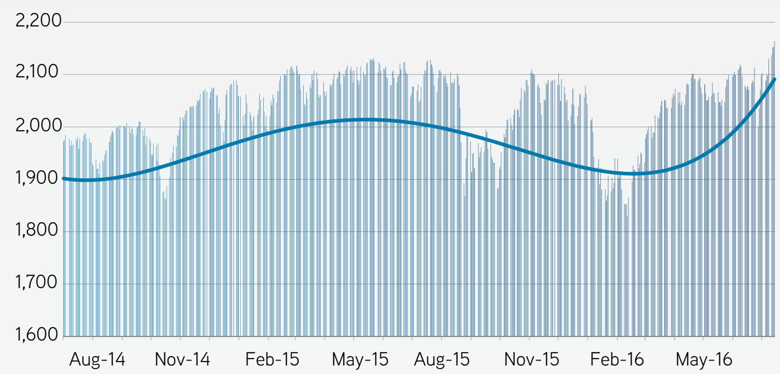
Colliers tracked 125 commercial real estate transactions over $1.0 million during the first half of 2016. Retail properties generated 40% of the sales volume for 2016 when more than $425 million in properties were sold. This was followed by resort/golf properties which secured a distant second place with $187.8 million in year-to-date sales.

Healthy demand continues to exist for prime Hawaii commercial real estate properties as both local and offshore investors played a big role in property acquisitions for 2016 to date. At midyear, 60.2% of the investment dollar volume came from offshore entities which spent $637 million, primarily on big ticket properties. The average transaction size by offshore entities was $18.2 million, whereas for local investors, it was $4.66 million. Local investors accounted for the majority (72%) of the transaction count.

Foreign Demand for Real Estate Increases

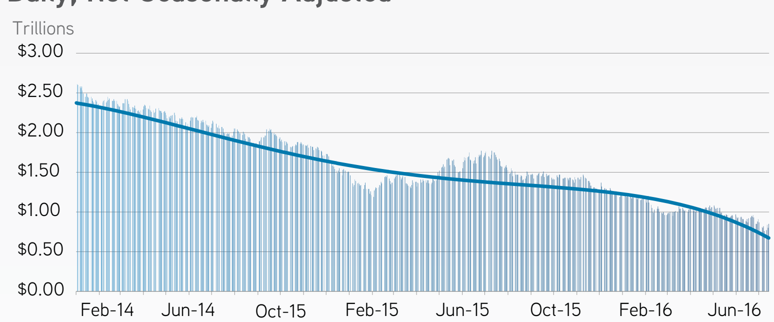
A volatile stock market, shrinking bond yields, declining commodity values, and falling currency exchange rates has led to foreign market unrest. As a result, there has been increased interest by foreign investors in U.S. real estate. At the end of 2015, investors were concerned over China's stock market crash and in July 2016, their concerns shifted to the impact of Brexit. Whatever the foreign crisis, investors typically respond with targeting safe haven investments like real estate.

S&P 500 Index (Daily, not seasonally adjusted)



Source: Federal Reserve Economic Data

10-Year Treasury Constant Maturity Minus 2-Year Treasury Constant Maturity
Daily, Not Seasonally Adjusted



Source: Federal Reserve Economic Data

While the global economic impact of the recent Brexit vote is still unknown, economists are anticipating that Britain will likely incur an economic downturn should the two year process to withdraw from the European Union actually materialize. The potential domino effect on other European countries would likely be even more destabilizing for the region should Grexit (Greece), Frexit (France) or Swexit (Sweden) follow. For the United States, increased European instability should result in an increased interest in U.S. real estate investments. Foreign investors realizing that the U.S. remains one of few markets that are projected to benefit from continued economic growth will be attracted to its relatively stable property returns.

For Hawaii, foreign investment activity is on the upswing. Mirae Asset Global Investments out of Korea, who had purchased the Fairmont Orchid Hotel for $200 million in 2015, has plans to acquire the Hyatt Regency Waikiki for $780 million this year. L.A. Koreana Inc., an affiliate of Koreana Hotels and Resorts out of South Korea, purchased the Hawaii Kai Golf Course in 2015 and is rumored to be acquiring the former Luana Hills Golf Course from Pacific Links this year. This would add another golf course to their portfolio which already includes Mililani Golf Course and Ewa Beach Golf Club.

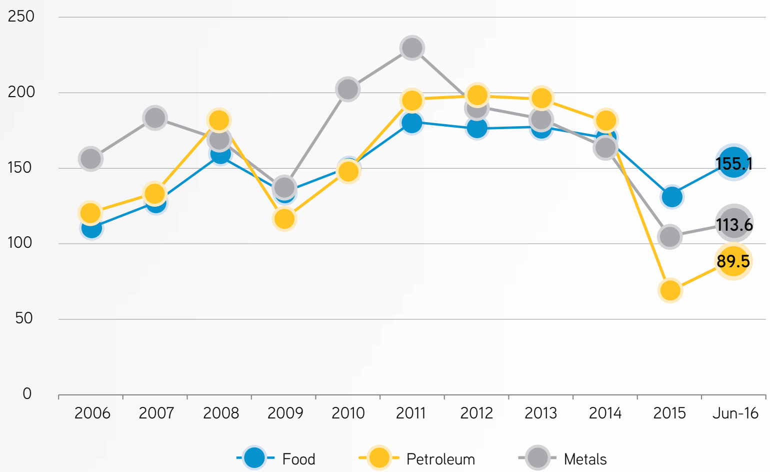
In addition to Korean interest in Hawaii real estate, the Chinese are making their presence known. The Resort Group sold Reignwood International 1,100 acres of Kauai land for $343 million in 2014 and followed this transaction with a 2015 sale of two Ko Olina resort development parcels for $200 million to China Oceanwide Holdings Group Co. Ltd. For 2016, China Oceanwide is rumored to be negotiating with Kapolei Property Development for the 516-acre Kapolei West residential development site.

Low Interest Rate Environment Spurs Increased Borrowing

While global uncertainty helps to drive foreign investment into the U.S., domestic investors continue to evaluate their investment portfolios in the search of higher yields. Low interest rates for money market certificates of deposit, bank savings accounts, and treasury bonds are motivating many investors to explore higher returns in alternative investments.

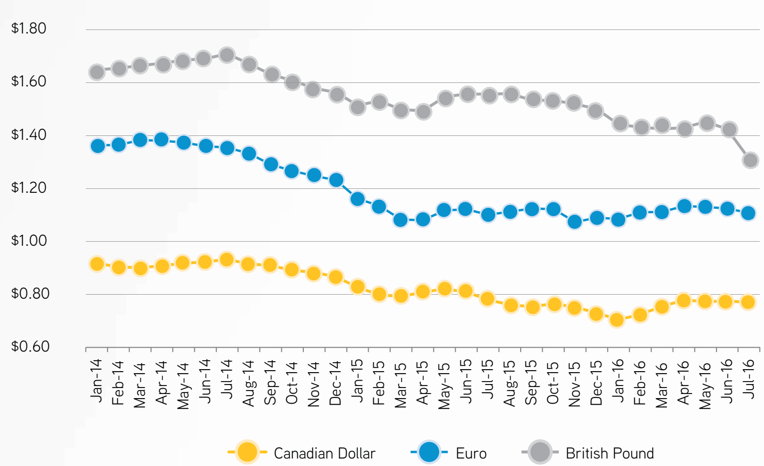
The Federal Reserve Open Market Committee ("Fed"), which controls short term interest rates, recently convened in July and delayed their previously planned interest rate hike. The Fed feels that near-term economic risks to the U.S. economy have diminished in light of the strengthening of the U.S. labor market and moderate economic growth. Should August and September economic data continue to support this optimistic outlook, there is an increased possibility that it will increase interest rates by December of this year.

Primary Commodity Price Indices (2006-2016)



Source: International Monetary Fund

Selected US Dollar Historical Monthly Exchange Rates



Source: Onanda

At least in the short term time horizon, interest rates should remain flat. Mortgage debt from commercial banks has risen quickly over the past five years as lenders are flush with cash. Between June 2011 and June 2016, U.S. commercial banks boosted total mortgage debt from $1.2 trillion to more than $2.0 trillion, a 66.7% jump in outstanding mortgages.

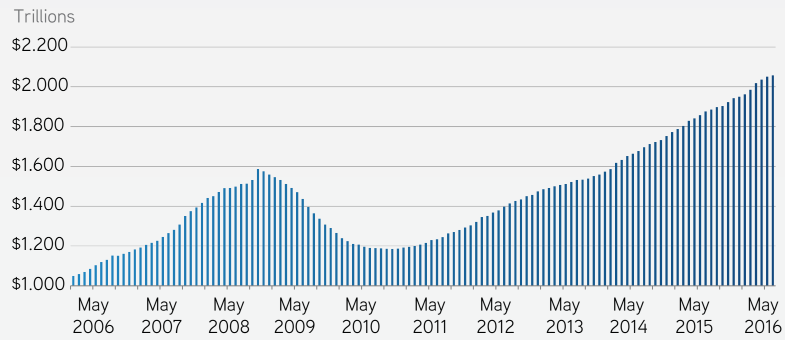
Rising Delinquency Rates for CMBS

During the 2006-2007 period, commercial mortgage backed securities ("CMBS") comprised up to 30% of the financing for commercial properties. During these two years, nearly $427 billion in CMBS funding occurred with what was believed to be the laxest underwriting standards leading up to the Great Recession. Many of these loans have ten-year maturity dates and will need to be refinanced this year.

The impact of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act on CMBS issuance included a "Risk Retention" provision that is set to come into effect December 24, 2016. This rule would require sponsors of the securities to hold 5% of a CMBS issuance on their balance sheet, or the buyer of the non-investment grade "B-Piece" to hold the security for at least 5 years as a risk retention measure. While the exact impact that this rule will have is unknown, this requirement is likely to lead to a more conservative approach from issuers and drive yields up. This reform act will likely inhibit the ability to refinance the riskiest CMBS tranches and result in an increase in default rates.

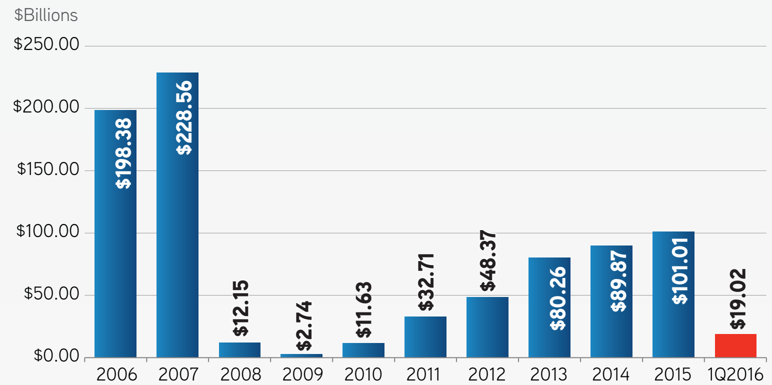
The CMBS delinquency rate had steadily crept upward since March, posting a 4.6% rate for June. While more than $500 million in loans were cured during the month of June another $2 billion in loans became newly delinquent, placing upward pressure on the overall delinquency rate. Currently, more than $22.5 billion in CMBS loans are delinquent and this figure is anticipated to increase as 2006 and 2007 loans reach maturity.

Commercial and Industrial Loans, All Commercial Banks (Trillions of U.S. Dollars, Monthly, Seasonally Adjusted)



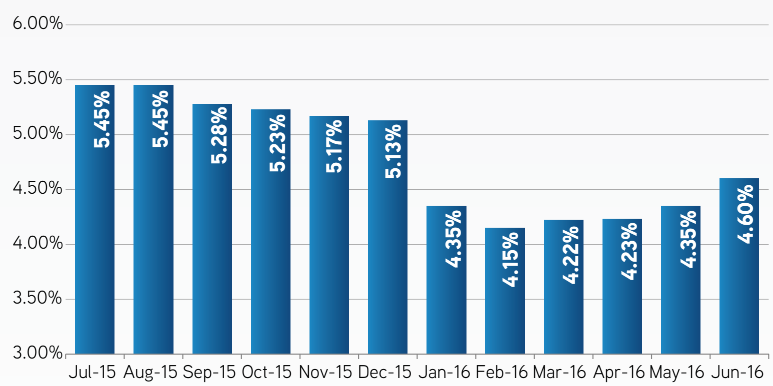
Source: Federal Reserve Economic Data

U.S. CMBS Issuance



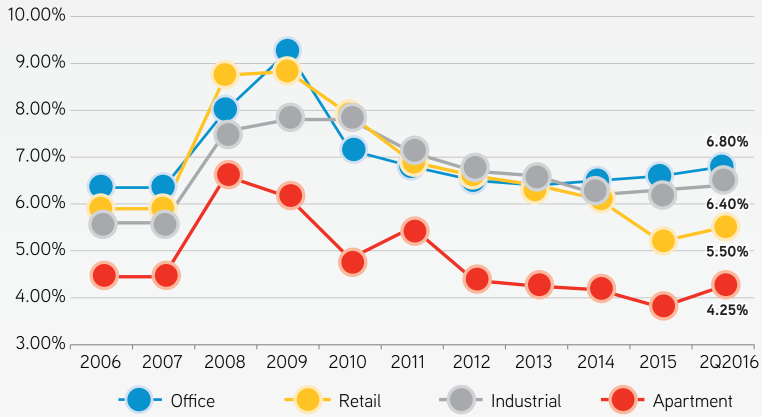
Source: Trepp, LLC

30+ Day CMBS Delinquency Rate

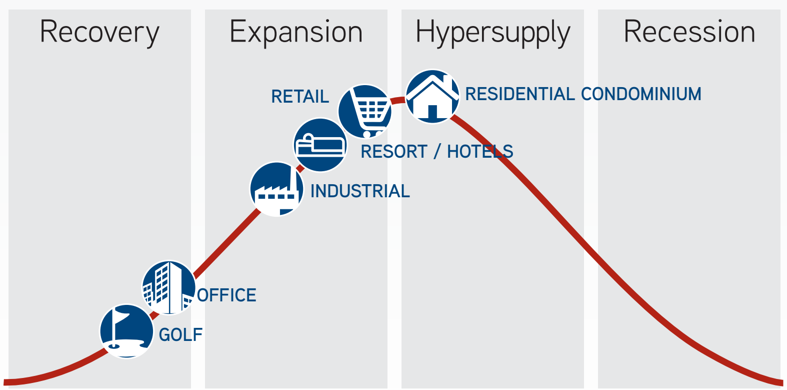


Source: Trepp, LLC

Hawaii Core Cap Rate Estimates



Colliers Hawaii Commercial Real Estate Cycle



Cap Rate Compression Slows

This boost in outstanding mortgages mirrored the surge in U.S. commercial real estate investment sales activity over the past few years. Rising demand for real estate assets helped to pushed property prices upward as investors competed for available properties. Capitalization rates, which is the ratio of net operating income divided by the sales price, steadily compressed between 2009 and 2016.

While Hawaii's cap rates also declined between 2009 and 2015, estimates for the first half of 2016 posted a slight increase over year-end 2015 levels. Generally, when cap rates increase, there is a perception that investment is riskier, possibly as the result of slowing economic growth or external/global volatility.

Real Estate Cycle Getting Long in the Tooth

The real estate cycle can be divided into four quadrants: Recovery, Expansion, Hypersupply and Recession. Vacancy rates, rental rates, development activity, and economic indicators are used to place each property sector at the various stages of the cycle.

Currently, the golf and office sectors remain in the recovery quadrant, as both have suffered from stagnant market conditions. Despite rising rents and strong demand for industrial space, the lack of available land on Oahu has inhibited development of additional warehouses and keeps the industrial market from moving upward on the real estate cycle. Similarly, the hotel sector benefits from rising room rates and healthy occupancy rates, but the lack of resort waterfront land dampens additional hotel development. The retail market is in the middle of a development surge with new supply likely to push vacancy rates upward resulting in concerns that this sector may be entering the hypersupply quadrant.

While the outlook for Hawaii's commercial real estate market remains optimistic, concerns are being raised as to when this "upcycle" will enter its final stage. Hawaii's real estate cycle typically lasts 7 to 10 years. With our economy entering its seventh year of growth, many prognosticators are watching for signs of a slowdown.

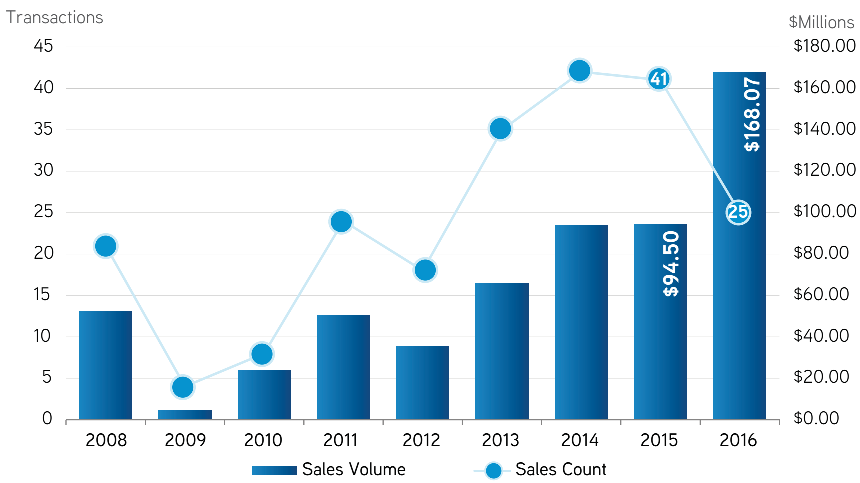
Earlier in the year, Colliers predicted that the record investment sales activity in 2014 ($4.6 billion) and 2015 ($4.5 billion) would be unsustainable and we would encounter a 20% decline in sales volume for 2016. While transaction activity and interest in Hawaii commercial real estate still remains healthy, much of this forecast hypothesis is based on the premise that the market would be restricted by a reduction in the number of properties that would be available for sale.

Colliers maintains its belief that while there still remains a strong likelihood that additional mega multi-million dollar transactions will occur, commercial real estate transaction activity will continue to decline from the 2014 record levels. Colliers anticipates roughly $3.4 billion in total sales volume by year-end 2016.

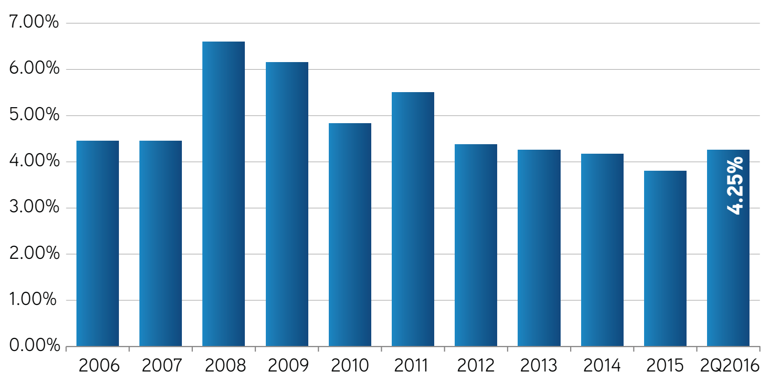
Apartment Market Performance

William "Bill" Froelich (B), JD, SIOR, CCIM, Senior Vice President

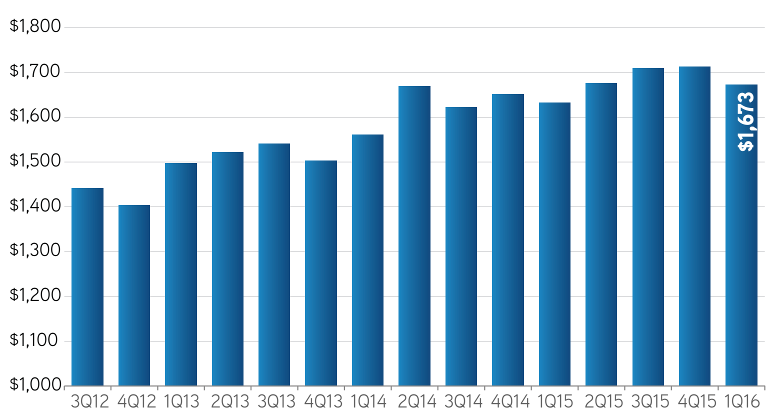
Hawaii Multifamily Sales Count vs. Sales Volume (June YTD)



Honolulu Apartment Capitalization Rates



Honolulu Average 2-Bedroom Monthly Rent



Source: MPF

Some may find it odd that investors would choose multifamily as one of the top asset classes across the state as well as the country. The management intensive nature of multifamily properties coupled with strict landlord-tenant codes and the personal relationship of renting a home to an individual or family would logically heighten risk and increase cap rates. However, time and time again, it is demonstrated that people prefer asset types that they understand (such as residential property), prefer the diverse income stream of multiple units, and feel that one of the best ways to build "sweat equity" is through multifamily ownership.

Honolulu is no different as it reported a first quarter 2016 average cap rate of 4.25%, average two bedroom rents of just under $1,700 per month, and average per unit prices of $273,863. All of this while enjoying a vacancy rate of just 1.9%! To put that into perspective, the current average national vacancy rate stands at over 4.0%, with Honolulu having one of the lowest vacancy rates resulting in one of the highest occupancy costs in the nation.


94-357 Farrington Highway


45-516 Pahia Road

A closer look at some of the subjective factors influencing Hawaii's multifamily sector sheds light on why the market is so tight and why investors continue to desire multifamily properties in Hawaii.

1. **Housing Supply and Barriers to Home Ownership:** Oahu's single family home needs were estimated by the State of Hawaii as requiring more than 25,000 units to meet rising demand. Despite Oahu currently going through a building boom not seen in decades, the planned unit numbers are only around 6,000 and the majority of this new inventory are luxury condominiums. When you combine this lack of supply with a median single family home price of almost $750,000, many of those desiring to transition out of rentals are unable to qualify to purchase market rate homes. For those that qualify for affordable units, demand remains robust as queues are formed days in advance for the limited amount of units.

   A family making $1,600 per week wishing to spend 50% of their income on home ownership and qualifies for 100% financing, could only afford a mortgage equal to $536,220. The problem is that there are very few programs allowing for 100% financing. A 15% down payment requirement would mean saving over $75,000 which would be extremely hard if one had to also pay rent at the same time.

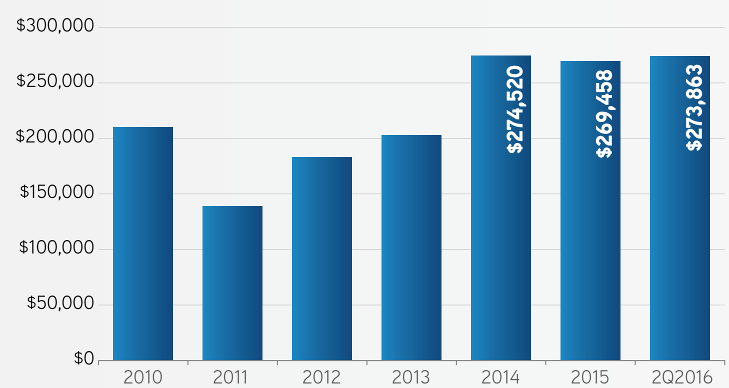
   This leads many to believe that rental rates are projected to continue to increase. In the event of a downturn to the residential market, many people believe that rental rates would also rise as fewer people qualify to purchase homes. It is a win/win for a multifamily property owner.

2. **Depreciation:** The IRS allows depreciation of multifamily buildings to occur over 27.5 years as opposed to the typical commercial building which uses a 39 year schedule. This puts more after-tax dollars in an investor's pocket as they can depreciate their asset faster.

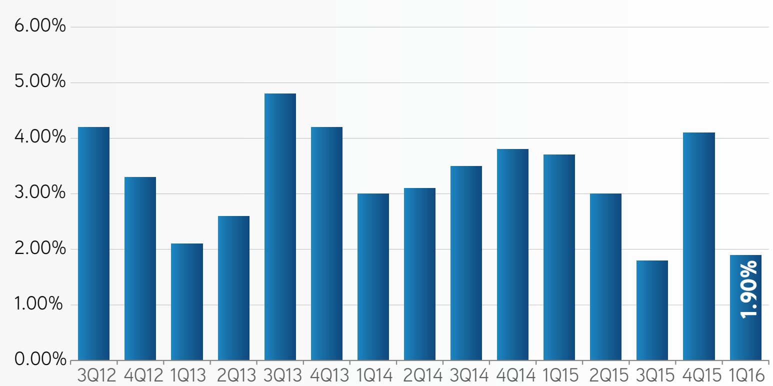
3. **Financing:** Many lenders see multifamily as a safe investment (never 100% vacant) and are able to offer attractive financing even below 4.0% interest rates. For buildings with less than five units, investors are able to get 30-year fixed financing similar to single family homes. Financing through Freddie Mac and Fannie Mae (which is unavailable for other property types) adds to the desirability.

These long term benefits, coupled with low interest rates and general demand to own a piece of paradise, lend credence to why multifamily investment is the darling in Hawaii and likely will be for the foreseeable future. Given these factors, many sellers have little motivation to sell their properties, and those that do are often listing them at capitalization rates below 4% based on pro forma numbers. Still, astute buyers are able to dig into the financials and find ways to add value through renovations, expense savings, or an undervalued rent environment.

Honolulu Average Price Per Multifamily Unit



Honolulu Apartment Vacancy Rate



Source: MPF

NOTABLE 2016 INVESTMENT TRANSACTIONS

PROPERTY TYPE	PROPERTY NAME	ACQUIRED INTEREST	SALES PRICE	BUYER ENTITY	SELLER ENTITY	SALES DATE
Multifamily	Oasis in Waipahu	406 units	$106,500,000	Di Napoli Capital Partners	Bascom Group	Mar-16
Multifamily	Palms at Kilani	106 units	$25,900,000	Di Napoli Capital Partners	Carmel Partners Inc.	Jan-16
Resort/Golf	Ala Moana Hotel	1,086 rooms	$52,500,000	Mantra Group Ltd.	Outrigger Enterprises Group	May-16
Resort/Golf	Ko'a Kea Hotel	121 Rooms	$50,000,000	Pacific Hospitality Group	CTF Ko'a Kea Hotel LLC	Jan-16
Resort/Golf	Waikoloa Marriott	555 rooms	$38,500,000	SMG I Hotel Waikoloa Ave (Silverwest Hotel Partners LLC)	Blackstone Real Estate Advisors	Apr-16
Land	Resort	3.31 acres	$20,000,000	Schnurr, Gary and Judith	KD Acquisition II LLC	Apr-16
Land	Commercial	20.97 acres	$12,500,000	SPD II Makaiwa Resort Development LLC	Coconut Beach Development LLC	Apr-16
Land	Agricultural	847.75	$6,300,000	RM Towill Corporation	Aina Ho'onanea LLC	Jun-16
Land	Commercial	32,000 sf	$6,200,000	DSD, LLC	Howell Kuli'ula Mahoe Jr. Revocable Trust	Feb-16
Office	Model Progress Building	58,760 sf	$14,000,000	San Ramon Valley Golf Course LLC	Niu Pia Land Company, Ltd	May-16
Office	810 Richards Street	79,120 sf	$12,000,000	Daxidi International Holdings LLC	Endless Luck LLC	May-16
Industrial	821 Eha Street	41,445 sf	$9,890,000	Fitzgerald Realty LLC	Scannell Properties #195 LLC	May-16
Industrial	633 Ahua Street	117,447 sf	$29,000,000	Extra Space Honolulu Ahua St, LLC	Diamond Head LLC	Apr-16
Retail	Maui Mall	185243 sf	$86,409,905	JLL Income Property Trust	Alberta Development Partners, LLC	Jan-16
Retail	Lahaina Cannery Mall	164,434 sf	$64,750,000	US Realty Partners Inc.	Property Development Centers, LLC	Jun-16
Retail	Symphony Condo	Ground Floor	$35,141,128	JN Group, Inc.	Oliver McMillan	Jan-16

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