Hospitality Research

2018 INVESTMENT FORECAST

Texas

Marcus & Millichap

Hurricane Boosts Hotel Performance; Supply Additions Bring Challenges

Robust pace of completions softens major metros' occupancy. Texas hotels ended 2017 on a high note as residents displaced by Hurricane Harvey sought temporary housing, filling rooms across the state and boosting occupancy and RevPAR growth for the year. The state contains the largest pipeline for new supply, which will challenge the hotel market in 2018. Approximately 200 hotels are under construction, bringing nearly 23,800 rooms, and an additional 276 hotels with more than 31,300 rooms are scheduled to break ground through the course of the year. These deliveries will drag on the overall occupancy rate this year, but Houston and Dallas will be most affected as they boast two of the largest construction pipelines in the country. A dip in occupancy in 2018 will moderate ADR and RevPAR growth through the year, as both will register lower than the five-year average pace.

Investors target Lone Star State for midscale and upscale hotels. Bidding activity was strong in Texas during 2017 and the number of hotels changing hands increased for a second consecutive year. Interest in midscale and upscale hotel chains grew over time, accounting for 45 percent of all trades during the 12-month span. Approximately one-quarter of all hotels trades occurred in the Dallas/Fort Worth Metroplex, though velocity was flat, but Houston and San Antonio registered an increase in activity as investors sought hotels priced between $1 million and $10 million. Cap rates for properties in this price tranche average between 9.5 percent and 10 percent but can range 200 basis points higher or lower depending on property age, chain scale and service level. Investors will be mindful of the supply pipeline in select markets like Dallas/Fort Worth and Houston. A strong economy and business environment in the Metroplex and those helping with restoration efforts in Houston will drive demand for rooms over the year.

2018 Demand Growth

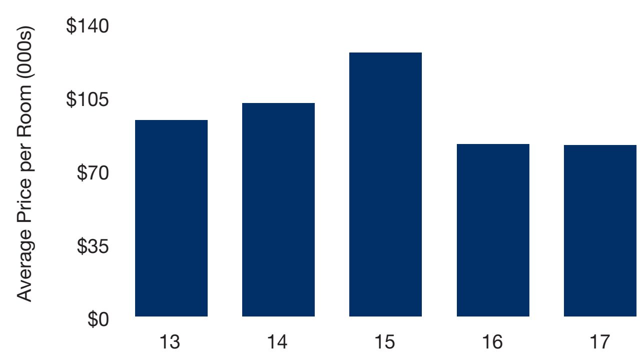
1.7% Year-over-Year Room Nights

2.8% 2017 Year-over-Year Leisure and Hospitality Employment Growth

-120 bps Five-Year Occupancy Growth 2014-2018

4% Five-Year RevPAR Growth

Hotel Sales

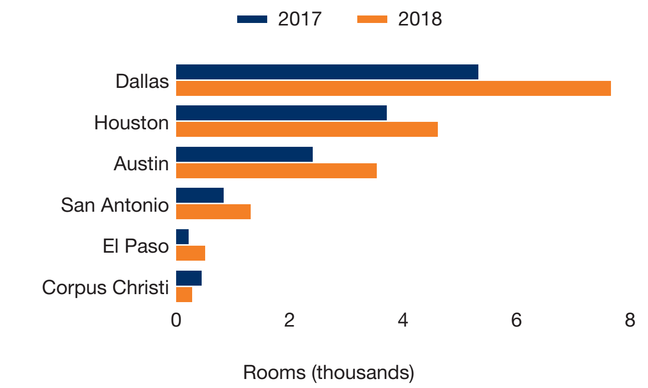


Sources: CoStar Group, Inc.; STR, Inc.; Real Capital Analytics

2018 Regional Highlights

- While the addition of thousands of new rooms to inventory in Dallas/Fort Worth is expected to weigh on occupancy, the rate currently sits approximately 850 basis points above the 14-year average and will likely remain in the mid- to high-60 percent area due to strong business and economic growth.
- Austin hotels continue to outperform the rest of the state, with occupancy remaining over 70 percent during 2017. The state's capital also hosts a number of large festivals each year, including SXSW and ACL, which draw significant tourist traffic.
- The flooding from Hurricane Harvey boosted hotel occupancy in Houston, providing some relief to the segment after falling energy prices slowed business travel to the market in 2015 and 2016. The rate ended 2017 up 430 basis points from the prior year at 66.7 percent.

Development Trends♦



2018 Region Forecast

Supply
up 2.2%

A 2.2 percent overall increase in available rooms is driven by the construction of upper midscale and upscale hotel rooms. These rooms account for nearly 6,400 of the rooms underway in Houston and Dallas/Fort Worth.

Occupancy
down 30 bps

As Houston residents continue to filter out of hotels this year and a large swath of new units come online, occupancy falls 30 basis points to 64.7 percent.

ADR
up 1.0%

Heightened room demand late last year resulted in a 2.0 percent increase in ADR, but the pace of growth slows in 2018 as the rate reaches $103.20.

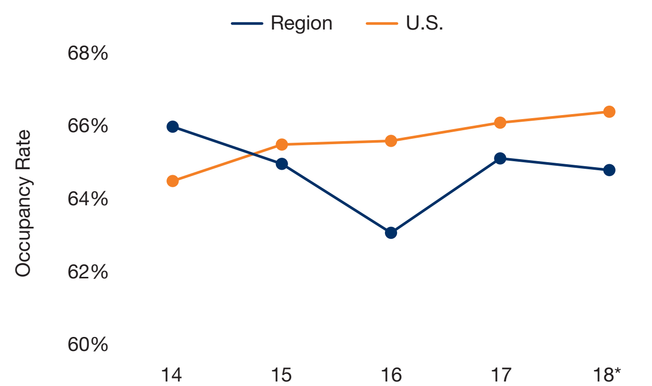
RevPAR
up 0.3%

This year's uptick in ADR combined with a slight decline in overall occupancy produce a minimal increase in RevPAR, which will reach $66.77 in 2018. RevPAR grew 5.3 percent during 2017, the strongest advance since 2014.

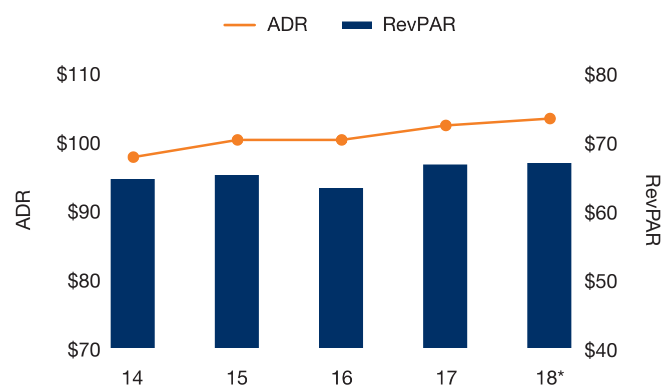
Investment

Hotels damaged by last year's hurricane along the Texas coast and in Houston will be targeted by investors seeking opportunities to add value.

Annual Occupancy



Full-Year Revenue Measures



♦2017 Recent Opens; 2018 Under Construction
* Forecast
Sources: CoStar Group, Inc.; STR, Inc.; Real Capital Analytics

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Sources: Marcus & Millichap Research Services; AH&LA; AARP Research; Altus Data Solutions; Bureau of Economic Analysis; CoStar Group, Inc.; Federal Reserve; Moody's Analytics; PKF Hospitality; Real Capital Analytics; STR Inc.; Trepp; U.S. Bureau of Labor Statistics; U.S. Census Bureau; U.S. Treasury Department.

Hospitality Research
State Report

Second Half 2017

Texas

Texas Hotels Feel Impact of Hurricane Harvey

Displaced residents from Hurricane Harvey seek shelter in Texas hotels. This year is expected to end on a high note for hotels, though at the end of the second quarter, occupancy declined year over year. Nearly all the major state metros, with the exception of San Antonio, registered a decrease in occupancy, average daily rate and RevPAR during the last 12 months. The metro of San Antonio posted healthy improvements among hotel demand drivers as rising room nights and limited completions fueled an increase in occupancy. As hotels filled rooms, ADR and RevPAR registered steady growth year over year. By year end, Texas will register gains in occupancy and revenue metrics as rebuilding efforts continue in the Houston metro after the landfall of Hurricane Harvey. Displaced residents, volunteers and workers have filled rooms. FEMA alone estimates that it has placed more than 53,000 individuals in area hotels as of September. ADR in Houston may also register gains despite local authorities' efforts to prevent price gouging. The upswing in occupancy amid rising ADR will boost RevPAR significantly in the short term. While Houston will register the largest impact in occupancy as a result of the hurricane, hotels in the markets of San Antonio, Austin and Dallas/Fort Worth may post occupancy gains as residents of Houston seek alternative housing options.

Bidding active in Texas hotels. Buyers remain active and transaction velocity rose year over year during the last 12 months ending in June. In particular, investors sought more upper midscale and upscale assets during this time. Demand also picked up in nearly all the major metros, with Dallas/Fort Worth and Houston comprising a significant portion of transactions. While many properties traded in the $1 million to $10 million price tranche, several assets changed hands above $20 million as institutional buyers remained active. Outside the major markets, several coastal cities garnered investors' attention amid rising visitors, including Corpus Christi. In Houston, hotel owners are assessing damage from Hurricane Harvey and determining how to better align their portfolios for their investment needs. Some hoteliers may opt to hold on to their properties as high occupancy drives income growth in the short term, while others investors may list their assets in hopes of capturing a higher price per room.

2017 Forecast

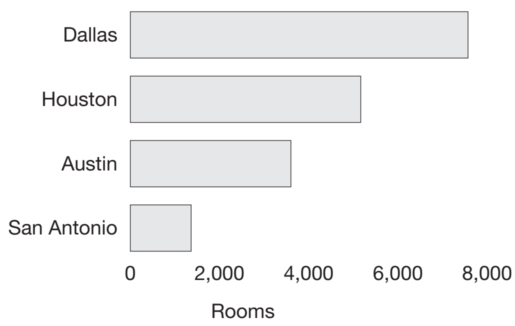
- **Large revenue jumps in short term amid hurricane recovery.** In the aftermath of Hurricane Harvey, statewide occupancy will rise in the short term as hotels remain occupied by displaced residents and volunteer workers. A slight increase in the average daily rate, coupled with the rise in occupancy, will push up RevPAR significantly.
- **Job growth persists.** All the major Texas markets posted job growth above the national rate during the previous four quarters, benefiting business travel demand. Dallas/Fort Worth registered the largest gain of 3.4 percent as 118,100 jobs were created during this time. Office-using employment jumped 4.7 percent in the metro, the largest increase among the major metros. Houston recovered from declining employment last year as 63,700 positions were created, up 2.1 percent year over year.
- **Last pipeline in United States.** The state of Texas boasts the largest construction pipeline in the United States, which may weigh on occupancy in the next few years. More than 23,300 rooms are under construction statewide and an additional 26,400 are in the final planning stages and expected to break ground in the next 12 months.

Metrics	2016	2017*
Occupancy	63.1%	71.8%
Demand Growth	0.1%	17.6%
Supply Growth	3.3%	3.4%
Average Daily Rate	$100.02	$103.85
Annual Change	-0.1%	2.8%
RevPAR	$63.28	$74.56
Annual Change	-2.8%	17.0%
Revenue Growth	-1.1%	20.9%

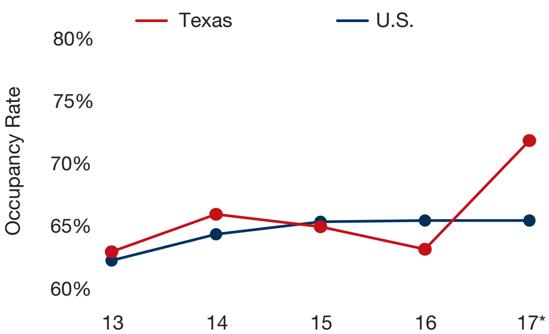
* Forecast
Sources: Marcus & Millichap Research Services; STR, Inc.

Marcus & Millichap

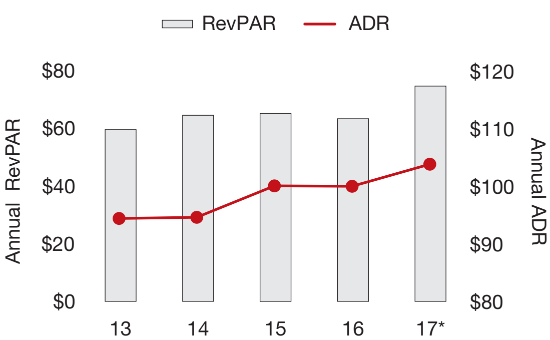
Under Construction Rooms



Annual Occupancy



Yearly Revenue Measures



* Forecast
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Price: $250

Occupancy Trends

- The room nights increase of 1.8 percent in Texas during the last 12 months ending in the second quarter did not outpace supply additions, lowering statewide occupancy 90 basis points to 67.6 percent in June. Occupancy has declined the past three annual periods.
- Declining room nights in Houston amid significant supply additions of roughly 5 percent lowered the metro's occupancy rate 400 basis points since last June to 61.4 percent. Approximately, 4,200 rooms were placed into service in Houston during the last 12 months. In Dallas, room nights declined 1 percent year over year while rooms available inched up 2.5 percent. As a result, occupancy in the market fell 260 basis points to 73.7 percent.
- The San Antonio metro registered the only occupancy increase among the major Texas markets. Occupancy in the area climbed 90 basis points during the last four quarters to 72.5 percent. Nearly 700 rooms were delivered during this time.

Revenue Trends

- The average daily rate in Texas ticked down 0.5 percent during the previous four quarters to $100.33. Declining occupancy in the state, coupled with the decrease in ADR, contributed to a 1.7 percent decrease in statewide RevPAR to $67.85.
- Declining occupancy in the Houston metro led to a 4.9 percent decrease in ADR to $98.16 while RevPAR fell nearly 11 percent during the previous 12-month period to $60.22. During this same time, ADR in Dallas ticked up marginally to $103.82 but the falling occupancy led to a 3 percent decline in RevPAR to $76.50 in June. The metro of Austin also posted decreases in revenue metrics during the past year. ADR and RevPAR in the area fell 0.1 percent and 4.0 percent, respectively.
- Improvements in occupancy in San Antonio benefited the metro's revenue metrics. The average daily rate climbed 3.8 percent during the year to $115.30 in June while RevPAR in the area jumped 5.1 percent during this same time to $83.58.

Sales Trends

- Buyers demand for Texas hotels remain healthy. Transaction velocity climbed 10 percent during the year ending in the second quarter as more select service properties changed hands.
- Limited and select service properties comprised the majority of sales during the last four quarters. Prices for limited service hotels averaged around $50,000 per key while select service assets changed hands at around $103,000 per room during this time.
- Improving hotel demand drivers fueled competition for hotel properties in San Antonio during the previous 12 months. The increased bidding in the metro lifted the average price considerably, with several properties trading above $100,000 per key.

Supply Growth Slows Operating Momentum; Texas Pipeline Largest in the U.S.

Projected drop in annual occupancy entirely the result of new hotels. After 13,000 rooms came online last year, this year's supply wave will mask a favorable turn in performance momentum that could generate somewhat better occupancy, ADR and RevPAR results than anticipated. Positive factors include the state legislative session in Austin that will provide hotel owners there an opportunity to increase occupied rooms from last year's record level. Activity has also resumed in the Permian Basin, where drilling rigs are being placed back in service as energy companies increase spending. Returning work crews, though, may be smaller than expected due to efficiencies gained during the downturn in oil prices. Overall, energy firms in the state are increasing budgets, a development supportive of additional energy sector travel. More broadly, Texas remains a job-creation machine and gauges of service sector activity reveal confident expectations of further growth in 2017. Several new office projects in Dallas, for example, will create new sources of room demand.

Investors becoming more tactical. Roughly 26,000 rooms are planned in the state, predominantly in areas other than Dallas and Houston. Due diligence periods are likely to extend this year as investors devote more time to fully understanding impending new supply, especially in Dallas, where supply growth will exceed demand at some point. In addition, the proliferation of new hotels across the state potentially limits rebranding options for investors, a commonly employed tactic. Within specific metros, Austin and Dallas will continue to elicit investor interest for their multiple demand drivers. Property owners in Houston, where transactions fell last year, will have new opportunities to rebuild property performance as the economy gains momentum. Assets in several areas, including the Medical Center, remain a constant draw. In San Antonio, many longtime owners of limited-service properties will seek exits through transactions.

2017 Market Forecast

Supply up 3.4% — Dallas, with 7,100 rooms under construction, and Houston, with 4,700 rooms underway, account for a sizable portion of the 26,000 rooms under construction statewide this year, an increase from one year ago.

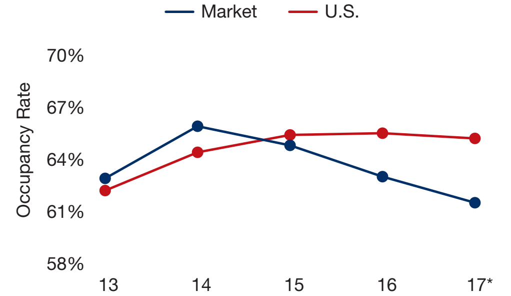
Occupancy down 150 basis points — A modest economic upswing in Houston contributes to a 1.0 percent rise in occupied rooms in 2017, besting last year's 0.3 percent rise. Supply growth, however, will push down annual occupancy to 61.5 percent.

ADR up 1.0% — Hosting the Super Bowl in Houston contributes to a slight increase in the statewide ADR in 2017 after a virtually flat performance last year.

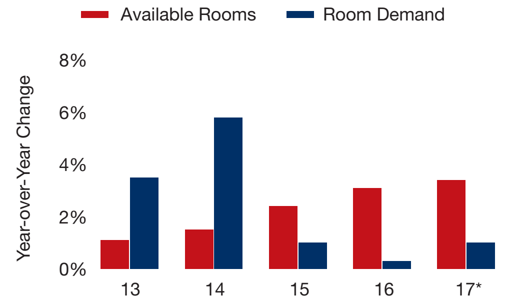
RevPAR down 0.6% — Dallas stands the best chance of bucking the statewide trend but will nonetheless post a slower rate of growth than last year's 5.7 percent jump. San Antonio also posts a slender gain.

Investment — The Wolfgang Shale is a new discovery of oil and gas reserves in the Permian Basin. Efforts to develop the field could lead to the deployment of new work crews that will require temporary accommodations.

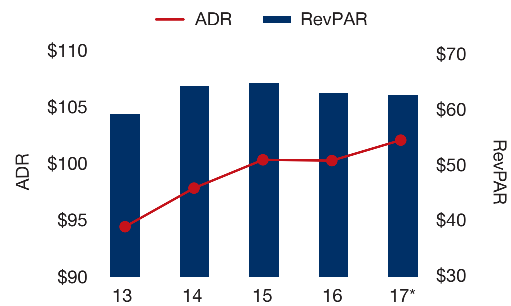
Annual Occupancy



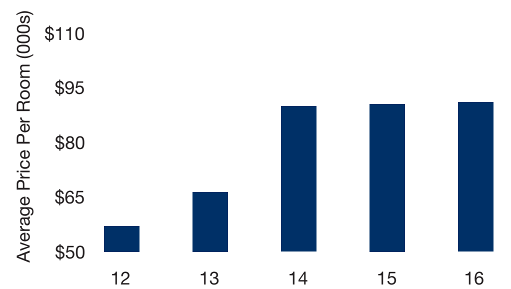
Supply and Demand



Full-Year Revenue Measures



Flagged Hotel Sales



* Forecast
Sources: CoStar Group, Inc.; STR Inc.; Real Capital Analytics

Marcus & Millichap

Hospitality Research State Report

Second Half 2016

Texas

Respectable Performance Gains Persist in Select Metros

Supply growth accelerates. The vibrant growth of the Austin and Dallas markets mostly offset softer performance in other areas of Texas, driving a modest gain in statewide room nights during the first half of 2016. Completions of new hotels, however, will continue to place downward pressure on the statewide occupancy rate and curtail operators' ability to set daily rates, resulting in mixed results for annual ADR and RevPAR. Hotels in the Austin, Dallas and, to a lesser extent, San Antonio markets will continue to benefit from their multifaceted demand drivers unaffiliated with the energy sector. Dallas, in particular, continues to benefit from a booming economy and positive trends in office-using industries. In Houston, several segments of the local economy are growing, but not sufficiently to drive inbound business travel volume to make up for the reduced travel budgets of the out-of-area vendors and consultants to Energy Corridor tenants. An area of consistent growth in Houston remains the Texas Medical Center, however, where specialty practices attract patients from beyond the metro. More than $3 billion in construction projects underway at the center will expand services and create new demand for accommodations for those traveling with patients from outside the area.

Deal volume remains elevated. Sales are on par with post-recession highs, but a decline was recorded from one year ago as owners and investors reassessed strategies. Conditions are present for buyers' and sellers' expectations to diverge, but sellers pricing assets to leave room to capture potential upsides may have the best opportunities to transact. Flagged economy and midscale hotels combined to capture a larger share of deals involving brand-affiliated hotels during the past 12 months, affirming the clout of small private capital with access to acquisition debt. However, the share of select-service assets decreased to less than half of all sales during the past year, partly reflecting a pullback of REIT purchases and greater circumspection demanded by the significant construction pipeline. More than 7,000 select-service rooms are under construction in Dallas and Houston combined. Key considerations for owners of upper midscale and upscale assets contemplating a sale include projected completions in the trade area and whether generators of room demand are insulated from the energy sector. Strong demand for select-service hotels persists, however, and assets in college, medical or military markets could elicit greater interest.

2016 Forecast

- **Pressure on Statewide Hotel Sector.** Annual occupancy will decline this year in response to reductions in business travel associated with the energy sector and an expansion of hotel inventory. The outperformance of Dallas and Austin will support a slight rise in the statewide ADR, but RevPAR will decline.
- **Developers Set to Bring More Rooms Online.** More than 20,000 rooms are under construction in the state and scheduled for completion over the next two years, and nearly 50,000 additional rooms are planned. Rooms under construction in Dallas and Houston collectively account for nearly half of all rooms underway in the state.
- **Energy Sector Outlook Changing.** The rotary rig count, a key indicator of activity in oil and gas fields, has climbed modestly over the past few months following a lengthy decline. Many energy companies are expressing intentions to return crews to the fields in the coming months if pricing can consistently hold near $50 per barrel. Concerns on global oil demand related to weaker overseas economies, however, reversed recent price gains and pushed down the price to the low-$40 per barrel range, complicating efforts to significantly restart production.

Metrics	2015	2016*
Occupancy	65.0%	63.6%
Demand Growth	1.0%	0.9%
Supply Growth	2.4%	3.1%
Average Daily Rate	$100.03	$101.03
Annual Change	2.2%	1.0%
RevPAR	$64.99	$64.22
Annual Change	0.9%	-1.2%
Revenue Growth	3.2%	-0.3%

* Forecast
Sources: Marcus & Millichap Research Services; STR Inc.

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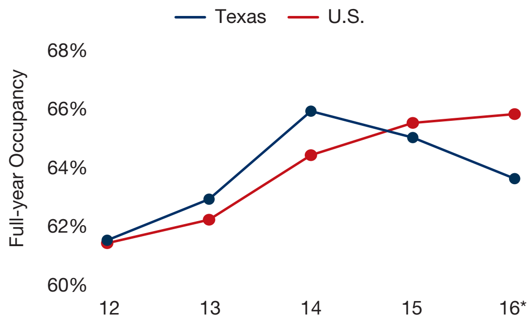
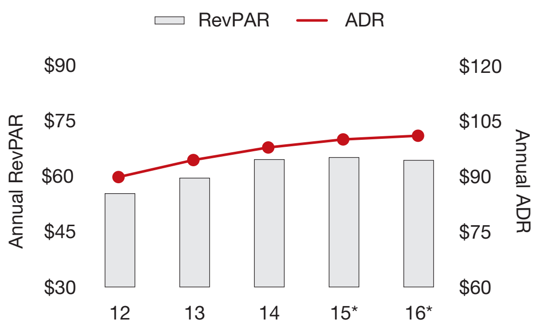
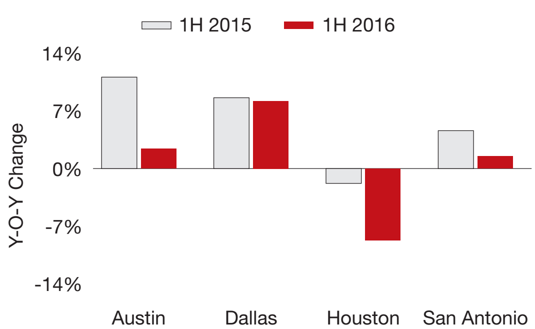
Annual Occupancy Rate



Texas ADR & RevPAR



RevPAR Change by Market



* Forecast
Sources: Marcus & Millichap Research Services; STR Inc.

Occupancy Trends

- The statewide occupancy rate slid 150 basis points in the first half of 2016 to 65.1 percent following a nominal increase in the corresponding period last year. New hotel openings and re-openings following upgrades raised available rooms 3.1 percent in the first six months of 2016, exceeding the pace logged nationwide. Softening demand in areas with heavy dependency on oil and gas supported only a minor increase in room nights statewide.
- Following mixed results in the first quarter, room demand grew substantially in Dallas in each of the ensuing three months. The gains recorded in the April-to-June stretch supported an increase in room nights of 4.8 percent for the entire first half and lifted occupancy 210 basis to 74.1 percent.
- A decline in inbound business travel related to the reductions in travel budgets in the energy sector underpinned a decrease in occupancy to 66 percent year to date in Houston. In Austin, a stout 5.2 percent gain in room demand was insufficient to overtake supply growth, resulting in a 110-basis-point drop in occupancy to a still-high 75.3 percent year to date through June.

Revenue Trends

- A slight increase in the statewide ADR joined with the drop in occupancy to yield a 1.8 percent decrease in RevPAR during the first six months of 2016. In the corresponding span one year ago, the statewide RevPAR advanced 2.9 percent.
- Dallas and Austin bucked the trend statewide, posting gains in RevPAR driven extensively by higher daily rates. In Dallas, RevPAR increased 8.2 percent in the first six months of this year, while a gain of 2.4 percent was registered in Austin. The dependence of each market on a mix of leisure travel and business demand not tied to energy will support steady RevPAR growth in the near term.
- RevPAR in San Antonio rose nominally in the first half following solid growth in the final three months of the period. In Houston, though, RevPAR declined more than 8 percent in the first six months of this year.

Sales Trends

- Declines in hotel performance in metros and markets with exposure to oil and gas contributed to a sizable decrease in transaction volume over the past 12 months. Despite an increase in sales of flagged economy inns outside of major metros, deals involving brand-affiliated assets slipped across the spectrum of chain scales.
- By metro, sales declined in Houston and Dallas but rose in San Antonio and Austin. The San Antonio market benefits from leisure destinations and room demand associated with federal facilities to garner keen investor interest in the select-service tier. In Austin, large investors seeking diverse room demand drivers secured assets in the limited-, select- and full-service tiers.
- Several consecutive years of elevated performance likely kept some Dallas properties from coming onto the market in 2016. Additional property owners in the metro may elect to leverage low interest rates in the coming months to monetize equity.

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