

# INVESTMENT MARKET

Mid-Year 2019

Accelerating success.

## Transaction Flow Remains Strong Despite Drop Off in Dollar Volume

**Mike Hamasu** Director of Research | Hawaii

After establishing a blistering record pace for 2018, Hawaii's commercial real estate investment market cooled considerably during the first half of 2019. Last year, mid-year sales volume topped \$3.09 billion. For the first half of 2019, commercial real estate investment sales volume posted \$1.29 billion, a dramatic 58.25% drop from last year. While the amount of investment dollars spent on commercial real estate slowed, the number of sales transactions for the year posted a solid 15.4% gain with the transaction counts increasing from 117 in June 2018 to 135 in June 2019.

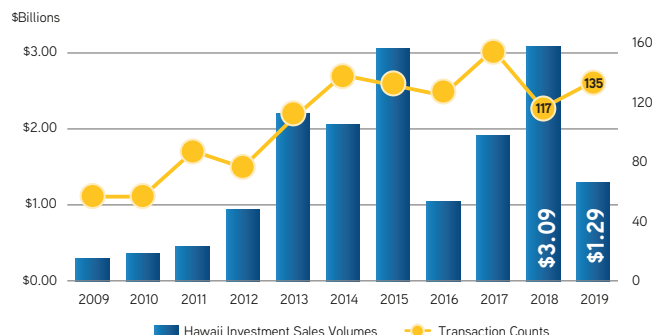
Hawaii's commercial real estate investment market has historically been heavily affected by megadeals (priced \$100 million and above), typically tied to sales of luxury resort hotels or prime shopping centers. By midyear 2018, there were seven megadeals which totaled a record high \$2.4 billion in sales volume. It is highly unlikely that megadeals for 2019 will come close to the year-end 2018 high. The lack of megadeal transactions is the primary reason for the dramatic drop in sales volume for 2019. So far, only three megadeals closed for a total of \$454 million during the first six months of the year.

*"There are only so many megadeals in Hawaii and they trade cyclically. After strong volume from 2016 to 2018, we expect to see fewer of them for at least a year or two while properties reposition."*

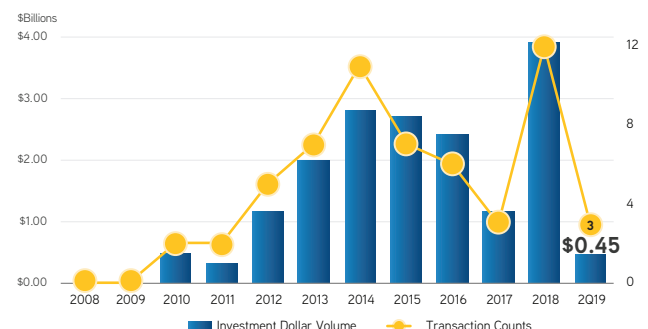
Scott L. Mitchell, (B), SIOR

Market Indicators	Mid-Year 2019
Relative to year-end 2018	
SALES VOLUME	↓
SALES COUNTS	↑
CAP RATE	↔

### Investment Sales Volume vs. Transaction Count



### Megadeal Sales Volume Vs. Sales Counts



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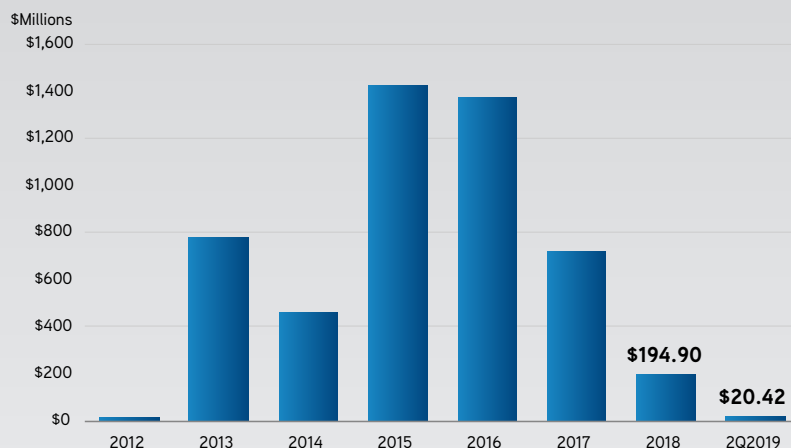
## Foreign Investment Drops

In addition to the reduction in the number of megadeals, Hawaii also faced a slowdown in international transactional volume. Hawaii has benefitted from strong international investment interest between 2013 and 2018. Investors from Japan, China, Korea, Australia, Singapore and Germany have acquired investment properties in Hawaii. While the reduction in Chinese investment capital was anticipated due to increased government restrictions on capital outflows, for the first six months of 2019, Hawaii recorded only two international transactions. This decrease in international sales volume from a midyear 2018 total of \$86.4 million to \$20.42 million at midyear 2019 (a 76.4% decline) continued the downward trend that started since 2016. In fact, between 2017 and 2018, there was an equally dramatic 88% drop in international transaction volume.

The larger of these international transactions was the \$19.2 million acquisition of the Ewa Hotel Waikiki by Belluna Honolulu LLC, a Japan-based mail order firm. The other was a purchase of \$1.22 million office condominium at 444 Hobron Lane by Sekai Mahikari Bunmei Kyodan, a Japanese religious organization.

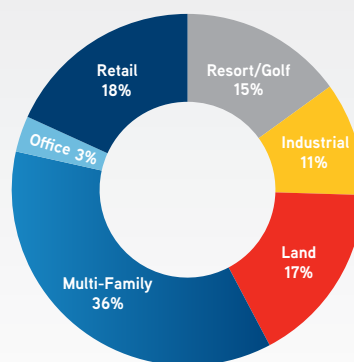
In addition to the reduction of both megadeals and international sales, the composition of the transactions for 2019 has differed significantly from those recorded at midyear 2018. At midyear 2018, sales volume had been concentrated in the resort/golf category totaling 53% of the dollar volume (\$1.01 billion). For 2019, multi-family transactions constituted the largest portion with 36% of the dollar volume. The resort/golf category recorded 15% of the total dollar volume, a smaller deal volume than both retail (18%) and land sales (17%). While the composition of commercial real estate transactions could potentially change by year-end, the investor popularity of multifamily properties has been a constant throughout this investment boom period.

## International Investment in Hawaii Commercial Properties

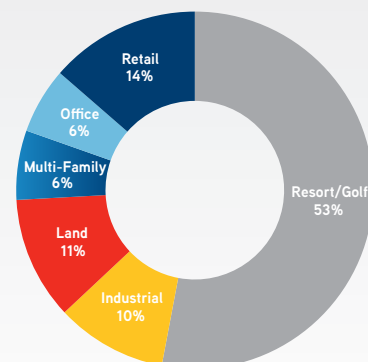


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## Percent of Total Sales Volume by Property Type



## Percent of Total Sales Counts by Property Type



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FIRST HALF 2019 SALES SUMMARY			SALES VOLUME			SALES COUNT		
	SALES VOLUME	SALES COUNT	LOCAL INVESTOR	DOMESTIC	INTERNATIONAL	LOCAL INVESTOR	DOMESTIC	INTERNATIONAL
Resort/Golf	\$194,210,000	5	\$-	\$175,010,000	\$19,200,000	0	5	1
Industrial	\$135,160,705	26	\$117,734,900	\$17,425,805	\$0	22	4	0
Land	\$216,920,420	25	\$143,993,827	\$72,926,593	\$0	17	8	0
Multi-Family	\$468,338,954	48	\$100,314,954	\$368,024,000	\$0	41	7	0
Office	\$42,820,000	7	\$41,600,000	\$0	\$1,220,000	6	0	1
Retail	\$235,182,921	24	\$179,432,921	\$55,750,000	\$0	21	3	0
<b>Totals</b>	<b>\$1,292,633,000</b>	<b>135</b>	<b>\$583,076,602</b>	<b>\$689,136,398</b>	<b>\$20,420,000</b>	<b>107</b>	<b>27</b>	<b>2</b>

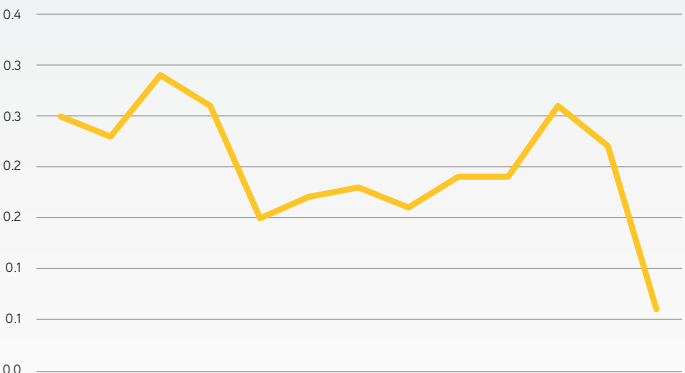
Kalaeloa Rental Homes



Queen’s MarketPlace



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



Source: Federal Reserve Economic Data

Multi-Family Investment Transaction Sales Volume Surges

The largest transaction so far this year was the acquisition by New York-based Blackstone Group (“Blackstone”) of a 520-unit former military housing portfolio (Kalaeloa Rental Homes) for \$211.5 million from Rockpoint Group (“Rockpoint”). Rockpoint acquired this portfolio from Carmel Partners in 2015 for \$154.5 million. This recent sale resulted in a healthy 36.9% gain for Rockpoint over the four-year period.

Another large multi-family portfolio was acquired by a partnership between California-based Standard Communities and Stanford Carr Development. The Hawaii Housing Finance and Development Corporation, a division of the State of Hawaii, sold its five-building leasehold public rental housing portfolio for \$138.9 million. The new ownership plans on investing more than \$85 million to renovate and upgrade these properties.

Blackstone Group and Alexander & Baldwin Are Top Investors for 2019

While sales volume for 2019 declined significantly, that has not dampened the enthusiasm of two institutional investors that have gone on a buying spree. Blackstone has been very active in Hawaii. Blackstone added the Courtyard by Marriott King Kamehameha’s Kona Beach Hotel and the Kalaeloa Rental Homes portfolio to their holdings. These acquisitions boosted their Hawaii investments to more than \$2.2 billion since the beginning of 2018. Blackstone’s Hawaii portfolio also includes Kapolei Lofts, The Ritz-Carlton Kapalua, Grand Wailea Maui and the Turtle Bay Resort.

When Alexander & Baldwin Inc. (“A&B”) sold 41,000 acres of land on Maui to Mahi Pono LLC in 2018, they were faced with the challenge of reinvesting the \$262 million proceeds into alternative properties. This led to A&B’s aggressive acquisition of more than \$217 million in properties during 2019. These purchases included: two retail centers (Waipouli Town Center and Queens’ MarketPlace); a warehouse development (91-620 Komohana Street); a land lease (91-570 Kapolei Kai, Lot 31); and a retail ground lease (land beneath The Home Depot in Iwilei).

Increased Market Volatility Anticipated

The U.S. economic expansion entered its tenth consecutive year, resulting in the longest run in recorded history. Due to the length of this upcycle, economists remain vigilant looking for any indications of a pending downturn.

On August 14, 2019, the 10-year vs. 2-year U.S. Treasury yield curve inverted. When short-term bonds yield higher returns than those paid by long-term bonds, it is generally a reflection of near-term negative investor sentiment. The perception is that increased short term risks warrant a higher return than those of longer term investments. Historically, when the yield curve inverts, it has preceded an economic recession. The recent inversion spooked investors, resulting in a sharp downturn to all stock indices that day and sparked increased market volatility.



# Commercial Real Estate *Outlook 2019*

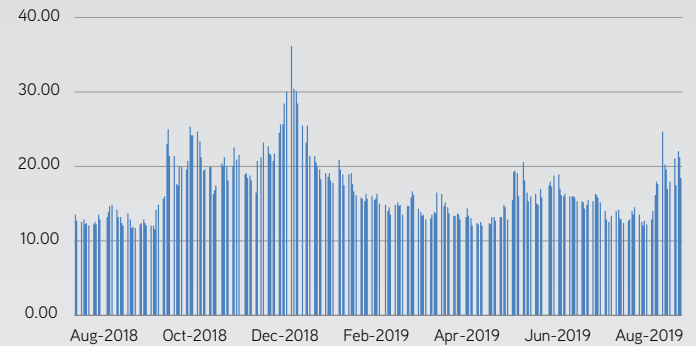
The Chicago Board Options Exchange Volatility Index (“VIX”) is known as the “investor fear gauge” and serves as a good indicator of near term market volatility or risk. In general, the VIX starts to rise during times of financial stress and declines as investors become complacent. While we do not know if this most recent yield curve inversion will be a harbinger of economic downturn, its impact on market volatility is evident by the sharp spike in the VIX during the past month. The most recent spikes in the VIX were associated with the breakdown in trade negotiations between China and the U.S.

Continued global trade tensions have only exacerbated the U.S. trade deficit as the dollar has strengthened against many foreign currencies. The Bloomberg Dollar Index, which compares the U.S. dollar to a basket of global currencies, just rose to its highest level in 2019. As the dollar grows stronger, U.S. goods and services become increasingly more and more costly to foreign customers.

The mere mention of the status of U.S. and China trade talks has rocked stock market indices. The tit for tat bickering among trade partners through the waging of tariffs, accusations of currency manipulation and unfair technology transfer have hampered progress and made resolution difficult. Global gross domestic product growth forecasts were negatively impacted by rising trade tensions between the U.S. and China.

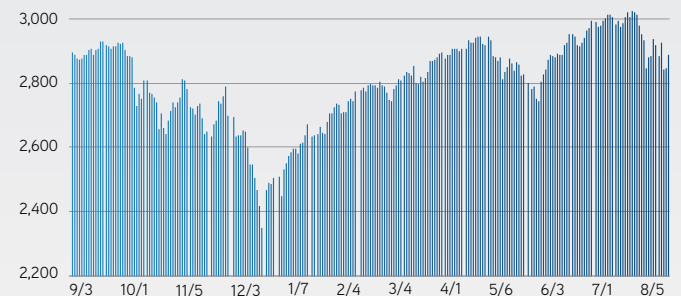
In times of uncertainty investors tend to move their investments from riskier assets into safe havens like government bonds, gold and real estate, thereby bumping up demand and prices. Bond yields move inversely to prices and, hence, have been turning negative. Japan, Germany and Switzerland have all posted bonds with negative returns implying that investors and central banks are predicting a continued low-yield environment. Gold prices, which surpassed \$1,500 per ounce, have reached their highest level in more than six years.

## CBOE Volatility Index



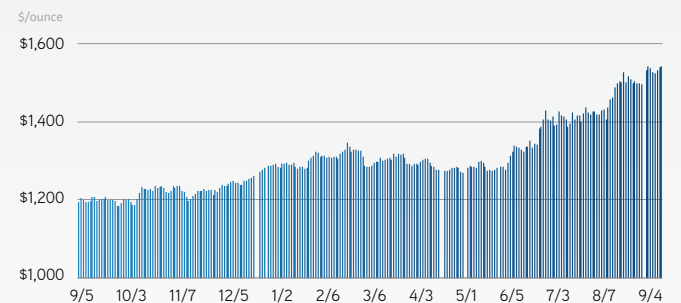
Source: Federal Reserve Economic Data

## S&P 500



Source: Federal Reserve Economic Data

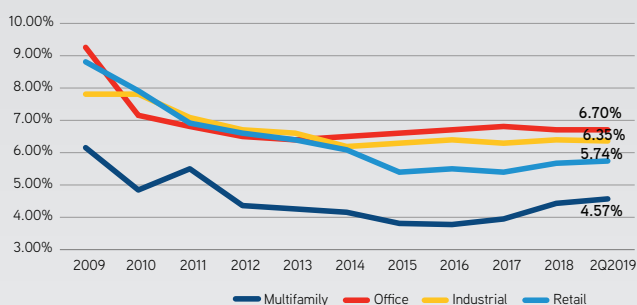
## Gold Prices



Source: Federal Reserve Economic Data

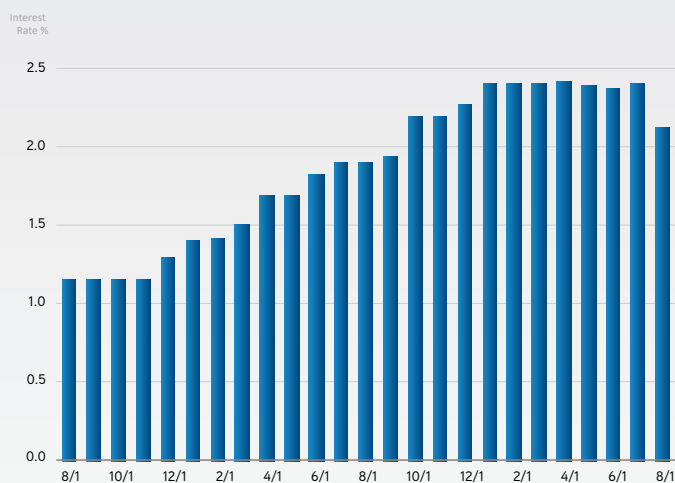


## Hawaii CRE Estimated Capitalization Rates



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## Federal Funds Rate



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## Capitalization Rates Flatten Out

Real Capital Analytics (“RCA”), a commercial real estate analytics firm, estimated that year-over-year U.S. national commercial real estate prices for June 2019 rose by a healthy 6.5% over last year’s levels. This continued a long trend of rising real estate values over the past six years. RCA also noted that the average national real estate capitalization rate, which tends to trend downward when real estate prices increase, posted a slight decrease at mid-year 2019.

For Hawaii’s real estate, Colliers estimated capitalization rates, which experienced a decline since the end of the Great Recession, had flattened out recently. Capitalization rates remained virtually unchanged during the past year, only recording minor differences to retail and apartment property types that rose a few basis points over the past six months. It appears that property returns have not been affected by the increase in stock and bond market volatility and the increasing concerns over the direction of the U.S. economy.

For the first time in nearly a decade, the Federal Reserve (“Fed”) reduced the Federal Funds interest rate by 0.25%. Acting to counteract negative economic news, the Fed’s response could potentially result in lowered commercial mortgage lending rates which could further incentivize investors to act on acquisition and development projects and boost sales activity.

Colliers forecasts that 2019 transaction counts will exceed 2018 year-end levels. Rising demand among investors should help to drive sales counts above 300 transactions for the year. Lowered bond yields, mortgage interest rates and rising stock market volatility will continue to encourage investors into the real estate marketplace. The lack of megadeals in the first half of 2019 will place a dampening effect on year-end 2019 investment dollar volume. Global volatility, exacerbated by rising trade tensions, will continue to inhibit foreign investment and Hawaii’s sales volume will drop below last year’s \$5.15 billion record levels by 40% to 45% at the end of 2019.

## NOTABLE 2019 INVESTMENT TRANSACTIONS

PROPERTY TYPE	PROPERTY NAME	ACQUIRED INTEREST	SALES PRICE	BUYER ENTITY	SELLER ENTITY	SALES DATE
Hotel	Courtyard by Marriott King Kamehameha Kona Beach Hotel*	452 rooms	\$103,500,000	BPP Kalaeloa Mezz LLC (Blackstone Property Partners)	Pacifica Hotel Company	Apr-19
Industrial	4545 Kapolei Parkway (StarAdvertiser Building)	152,574 sf printing facility	\$40,000,000	Tradewind Capital Group Inc.	Oahu Publications Inc.	Mar-19
Industrial	91-0620 Komohana Street (Kapolei Commerce Center)	93,057 sf warehouse	\$26,500,000	Alexander & Baldwin Inc.	Avalon Development Company	Apr-19
Land	421 Alakawa Street( Home Depot Iwilei Ground Lease)	392,084 sf land	\$42,400,000	Alexander & Baldwin Inc.	HD Hawaii 421 Partnership	Mar-19
Land	91-570 Kapolei Kai Lot 31	1,585,584 sf land	\$41,000,000	Alexander & Baldwin Inc.	Avalon Development Company	May-19
Multifamily	Kalaeloa Rental Housing Portfolio	520 units	\$211,500,000	Blackstone Group LP	Rockpoint Group Inc.	May-19
Multifamily	State Rental Housing Portfolio	1221 units (six buildings)	\$138,900,000	Standard Communities (Stanford Carr Development)	Hawaii Housing Finance and Development Corporation	May-19
Office	925 Dillingham Blvd	54,696 sf building	\$27,500,000	City & County of Honolulu	Tradewind Capital Group Inc.	May-19
Retail	69-201 Waikoloa Drive (Queens Marketplace)	135,000 sf building	\$90,000,000	Alexander & Baldwin Inc.	Waikoloa Land Company, Inc.	May-19
Retail	2080 Kalakaua Avenue (King Kalakaua Plaza)	82,390 sf building	\$51,250,000	Kalahana Partners	The Decurion Corporation	Mar-19

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