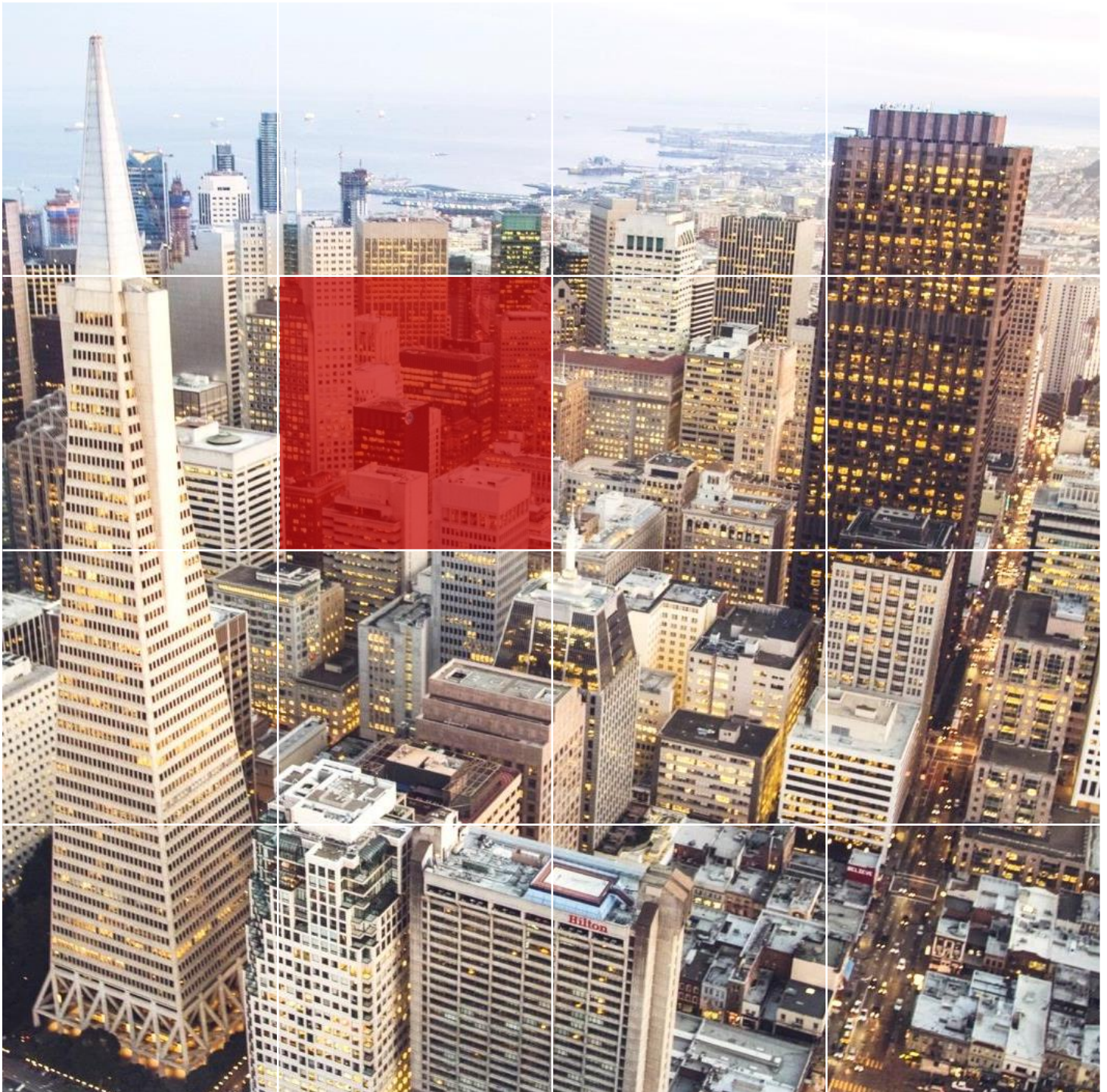


# *Hotel Intelligence San Francisco*

June | 2015



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## *Market insight*

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- San Francisco's lodging market growth continues as revenue per available room (RevPAR) increased 13% in 2014, driven by increases in average daily rates. Year-to-date May RevPAR is up over 12% compared to the same period last year.
- The market recorded \$900 million in hotel transaction volume in 2014, a level of activity that has remained consistent over the past three years. Transaction activity in 2015, however, has already surpassed the total 2014 volume less than halfway through the year and appears poised to surpass the prior 2006 peak.
- Limited land availability combined with substantial development costs have kept new hotel development in check with the last new San Francisco hotel built in 2012. The pipeline remains minimal with two hotels projected to open in 2015.

## *Contributors*

John Strauss  
Managing Director  
[john.strauss@am.jll.com](mailto:john.strauss@am.jll.com)

Andrea Grigg  
Executive Vice President  
[andrea.grigg@am.jll.com](mailto:andrea.grigg@am.jll.com)

Kent Michels  
Associate  
[kent.michels@am.jll.com](mailto:kent.michels@am.jll.com)

Eric Gorenstein  
Analyst  
[eric.gorenstein@am.jll.com](mailto:eric.gorenstein@am.jll.com)

Billy Shen  
Analyst  
[billy.shen@am.jll.com](mailto:billy.shen@am.jll.com)

# Hotel Intelligence San Francisco

San Francisco is a major gateway to Europe, Asia and Australia. The lodging market posted double-digit year-over-year growth in average daily rate in 2014 and boasts one of the highest occupancy levels among the top-25 U.S. lodging markets. The city is home to numerous internationally renowned tourist attractions, and the economy and commercial real estate markets are thriving with the expanding presence of technology companies.

## Diversified economy with significant tech presence

The San Francisco Bay Area boasts a diverse, fast-growing economy as well as numerous cultural and tourist attractions, which have helped establish it among the nation's top-performing lodging markets.

While the region is renowned for featuring the world's largest concentration of leading technology and venture capital firms, the San Francisco metropolitan area is also among the most economically diverse in the country, with significant activity in the international trade, financial services, business services and retail sectors. The region's 31 Fortune 500 companies include technology beacons, such as Apple, Google and Facebook, as well as traditional blue-chip companies, including Chevron, Charles Schwab and Visa. Given its high concentration of knowledge-based industry, San Francisco has become a preeminent hub for intellectual and entrepreneurial talent, and the Bay Area boasts the highest GDP per capita in the U.S. at \$85,300 per employee.

Moreover, the city's iconic attractions – Union Square, Lombard Street, Ghirardelli Square and the Golden Gate Bridge, to name only a few – drew an estimated 18 million tourists to San Francisco in 2014 according to San Francisco Travel. The city's status among the top tourist destinations in the world combined with its position as an economic powerhouse and center of innovation allow for consistently strong demand for hotel rooms – on weekends and weekdays, regardless of the time of year.

*In 2014, visitation to San Francisco increased 6.5% to 18 million visitors, generating a record-breaking \$10.7 billion in visitor spending.*

## San Francisco expected to see 10% to 12% RevPAR growth in 2015

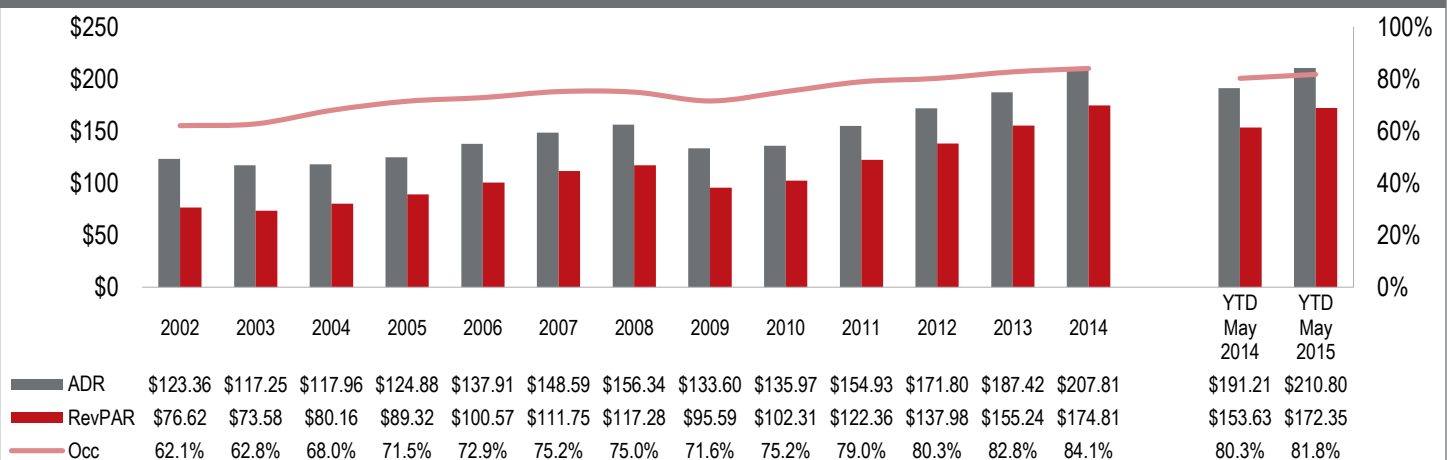
After strong performance in 2013 with revenue per available room (RevPAR) growth of 12.9%, San Francisco's lodging market continued to power forward in 2014. Annual market-wide occupancy reached 84.1%, leaving San Francisco's occupancy only 70 basis points lower than that of New York, which has commanded the highest occupancy among the top-25 U.S. markets since 2012. Given year-to-date May occupancy growth of nearly 2% for San Francisco, compared to stagnant growth in new supply-laden New York, San Francisco appears poised to overtake New York as the nation's highest occupancy rate market in 2015.

*Revenue per available room in the San Francisco market ranked third among the top-25 U.S. markets in 2014, behind only New York and Oahu.*

The San Francisco market's high occupancy rate has allowed for significant ADR increases in recent years. Remarkably, ADR growth exceeded 9% for each of the past four consecutive years, and as occupancy has approached its structural ceiling, ADR growth has been the primary driver of RevPAR gains. Most recently, ADR growth of nearly 11% in 2014 and over 10% year-to-date through May in 2015 fueled market RevPAR growth of 13% and 12%, respectively.

*Among the top-25 U.S. markets, San Francisco achieved the 2<sup>nd</sup> highest rate of ADR growth in 2014 and is on pace with the 2<sup>nd</sup> highest ADR growth rate yet again in 2015.*

## San Francisco/San Mateo lodging performance



Source: Smith Travel Research

JLL projects RevPAR growth in the range of 10% to 12% for the San Francisco market in 2015. San Francisco's stellar lodging market performance, both recent and projected, is attributable to extremely favorable demand and supply dynamics in the region.

Specifically, the lodging market is poised to benefit from several key trends, including (1) strong technology-led economic growth, (2) significantly improved airlift from San Francisco International Airport, (3) material increases in convention center activity as well as (4) constrained new supply growth in the context of (5) scheduled improvements to the market's existing hotel stock.

### Strengthening market fundamentals

**1. Technology-led economic growth:** The San Francisco metropolitan area achieved average annual real GDP growth of 4.5% between 2012 and 2014, during which time overall U.S. real GDP growth amounted to only 2.3%. San Francisco's impressive growth trajectory is largely attributed to the market's technology and related venture capital industries, which exhibit no indication of slowing down in the near term. The number of tech industry jobs increased 67% between 2004 and 2014, according to Praxis Strategy Group. Furthermore, high-tech jobs now make up 28% of all office jobs in San Francisco, an all-time high, as recent start-ups such as Uber and Palantir have achieved explosive growth and more established companies such as Google and Apple continue adding to payrolls.

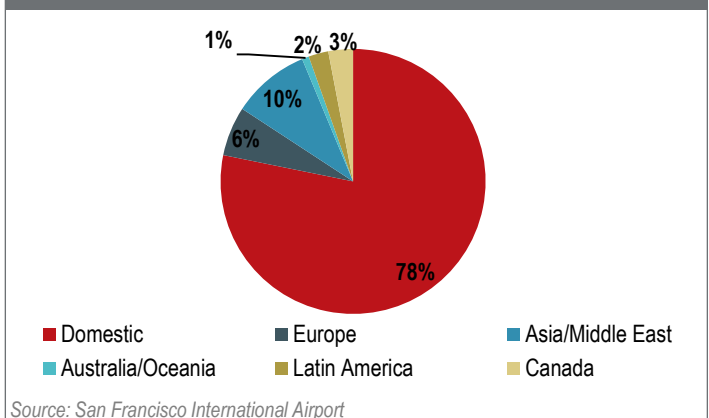
San Francisco-San Mateo-Redwood City, CA economic and demographic indicators								
Indicator	2011	2012	2103	2014	2015F	2016F	2017F	2018F
Real gross metro product (C\$B)	146.8	154.3	161.3	167.3	173.8	178.0	182.3	185.1
Percent change	-4.5	5.1%	4.5%	3.7%	3.9%	2.5%	2.4%	1.5%
Unemployment rate	8.1%	6.9%	5.5%	4.5%	4.3%	4.4%	4.3%	4.2%
Population (000's)	1,799	1,822	1,843	1,860	1,878	1,896	1,914	1,933

Source: Moody's Analytics

**2. Improved airlift at San Francisco International Airport (SFO):** In 2014, activity at San Francisco International Airport climbed to a record-setting 23.6 million passenger arrivals, representing an increase of more than 5% from the prior year level. New international routes, including direct service to Wuhan, Chengdu, Dublin and Abu Dhabi, have contributed to the strong uptick in passenger activity. Growth in international passenger arrivals outpaced domestic travelers' growth, and considering the introduction of additional international routes in 2015, including non-stop service to Istanbul, Sydney and Panama City, the international demand segment is anticipated to enjoy continued growth. Furthermore, plans to spend \$2.4 billion expanding and modernizing Terminal 1 at SFO are scheduled to commence in late 2015 and reach completion by 2024.

*International arrivals accounted for 22% of total arrivals at SFO in 2014. Arrivals from Latin America and Canada each grew more than 10% from their respective 2013 levels.*

San Francisco International Airport passengers by origin (2014)



**3. Major convention center expansion:** After completing a \$56 million renovation in 2012, San Francisco's Moscone Center – the third largest convention center in California – is undergoing a significant expansion that began in 2014. Projected to cost \$500 million upon its completion in 2018, the project will add an additional 305,000 square feet of functional event space, which will enable the city to attract larger conventions and substantially increase group demand for lodging establishments.

*San Francisco has the most hotel rooms located within a one mile radius of its convention center as well as the most rooms per square foot of exhibit space among the major U.S. convention markets.*

**4. Constrained new supply pipeline:** The active supply pipeline for the San Francisco lodging market remains tight at less than 2,000 new hotel rooms, representing less than 4% of existing rooms inventory. While the redevelopment of existing inventory in San Francisco potentially adds another two percentage points to the pipeline if included among the tally, it remains lower than that for most major markets in the U.S. Supply growth is expected to remain minimal given the significant cost and lengthy approval process required for new development in the city.

Specifically, large-scale office and residential development is driving up construction costs in the city, with more than 3 million square feet of new office space under construction. Demand for contractors is currently at a record high across the commercial real estate sector, causing construction costs in San Francisco to rise 6% in the last year – more than any other major U.S. market.

The opening of a 174-room Hampton Inn in 2015 will mark the city of San Francisco's first new hotel in several years. Most new hotel development will occur in the surrounding San Francisco/San Mateo metropolitan area with only a few new hotels planned for San Francisco proper.

Zephyr Hotel—a play to drive results without a brand in a market with limited supply and robust demand.

### Downside risk from potential wildcards

While our baseline outlook for the San Francisco market is optimistic given the region's strong underlying demand and supply fundamentals, there are potential, however outlying, risks to our demand and supply growth expectations.

- 1. California's ongoing drought:** California is currently in the fourth year of an epic drought that has already prompted a mandatory 25% reduction in water consumption for state residents. The system of reservoirs that services the San Francisco area was at only 54% of capacity as of early June 2015, with the dry summer months still ahead. Though conservation efforts in San Francisco have proven relatively successful, leaving the area's water supply in much better shape than is the case for many other parts of California, concerns still abound about the implications for the region in the event that the drought continues for years to come.
- 2. Competing, low-cost technology markets:** While the San Francisco market is considered the epicenter of technology and related industries, the cost of doing business in the region is high given an extremely competitive labor market, expensive real estate and aggressive local taxation. For example, asking rents for Class A office space in Austin, Seattle and Chicago are approximately 50% lower than asking rents for Class A office space in San Francisco. As a result, those markets have emerged as lower-cost alternatives for technology companies seeking to start or expand their operations. To the extent less expensive areas succeed at nibbling away at San Francisco's preeminent stake in this market, economic growth in the region – and the lodging demand that it generates – could potentially soften.
- 3. Potential cap on economic growth:** While prohibitive new development costs have served to boost occupancy and ADR for existing hotels in San Francisco, inventory constraints ultimately risk inhibiting the city's economic growth potential. Meeting planners

San Francisco hotel development pipeline and recent openings				
Under construction				
Project	Location	Rooms	Expected opening	Positioning
Hampton Inn Convention Center	952 Mission St	174	2015	Upper Midscale
Courtyard San Francisco Union Square	761 Post St	166	2015	Upscale
Proposed sites				
Project	Location	Rooms	Expected opening	Positioning
Marriott San Francisco Mission Bay	Channel St & 3rd St	250	2018	Upper Upscale
Hyatt Place San Francisco	Not available	228	2019	Upscale
MOXY San Francisco Downtown	1196 Columbus Ave	65	2017	Economy
Recent openings				
Hotel	Location	Rooms	Open year	Positioning
Inn at Presidio	42 Moraga Ave	22	2012	Luxury

Note: Projects and dates are subject to change  
Source: JLL, Smith Travel Research

**5. Existing hotel stock improvement:** While new hotel development is constrained given the San Francisco market's significant barriers to entry, many hotels have undergone upgrades and renovations during the last two years in order to remain competitive in the region's strong lodging market. Notable renovations have taken place at the former Mandarin Oriental, Westin St. Francis, Fairmont San Francisco and Hilton San Francisco Union Square, as summarized in the table below.

Investors have also pursued re-branding strategies to gain exposure in this high barrier-to-entry market. Loews Hotels acquired and reflagged the Mandarin Oriental as the Loews Regency in order to gain a San Francisco presence, and Host Hotels & Resorts reopened the former Powell Hotel as the Axiom Hotel in an effort to develop its own boutique brand. Conversely, Davidson Hotels & Resorts dropped the flag of the Radisson Fisherman's Wharf and introduced the boutique

San Francisco hotel renovation projects						
Property	Rooms Renovated	Total cost	Cost per key	Opening/projected opening	Improvements	
Mandarin Oriental	155	N/A	N/A	Q2 2015	Rebranding to Loews, minimal improvements given renovation in 2012.	
Villa Florence Hotel	189	\$9,500,000	\$50,300	Q1 2015	Phase one of the renovation covered guestrooms and corridors with the addition of 7 rooms that were converted from meeting rooms or splitting up suites. Phase two includes lobby, meeting room and bar renovation.	
Axiom Hotel (formerly Powell Hotel)	152	\$22,000,000	\$144,700	Q3 2015	Closed in December 2014 for renovation, expected to reopen in fall of 2015.	
Ritz Carlton	336	\$27,000,000	\$80,400	Q4 2014	Renovation of 23,000 square feet of meeting space including ballroom, conferences and boardrooms. Refurbishment of all guestrooms expected to be completed in Q2 2015.	
Westin St Francis	569	\$20,000,000	\$35,100	Q2 2014	Renovation of 569 guestrooms and corridors in the Tower Building.	
Fairmont San Francisco	592	\$21,000,000	\$35,500	Q2 2014	Renovation of all 592 guestrooms.	
Hilton San Francisco Union Square	612	\$25,000,000	\$40,800	Q2 2015	Renovation of 575 rooms in the Tower 1 building that will have similar features to previous renovation. An additional 37 rooms will be added to the inventory, bringing the hotel total to 1,919 rooms.	
Hotel Zephyr (formerly Radisson Fisherman's Wharf)	361	\$29,000,000	\$80,300	Q2 2015	Re-opened as the Hotel Zephyr, a boutique brand that caters to millennials featuring 361 waterfront rooms.	
Hyatt Fisherman's Wharf	313	\$1,000,000	\$3,200	Q2 2015	Renovation of 19,000 square feet of function space.	

Source: JLL, publicly available information

routinely cite the city's shortage of hotel rooms and the high cost of lodging among the major drawbacks for holding events in San Francisco. Moreover, demand growth for office space has also outstripped new supply, which is subject to an annual cap per Proposition M. As a result, office rents have more than doubled in 5 years, making it difficult for less lucrative companies to expand while inducing others to relocate from the city's core. While limited new construction may be a boon to owners of existing real estate assets in the near term, the city's overall economy would benefit from more balanced supply and demand dynamics in the long term.

average price per key has climbed steadily higher. In 2014, average price per key for the San Francisco market, including the city proper as well as surrounding metropolitan area, reached \$316,000, representing a 15% premium to the prior peak level. The city has seen an increasing number of upper-upscale and luxury properties trade at record prices.

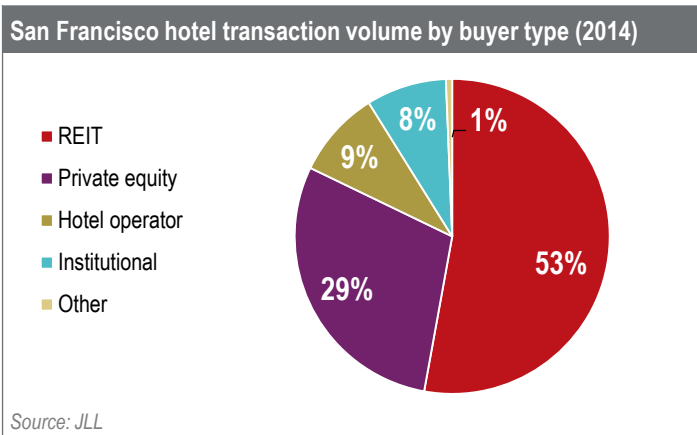
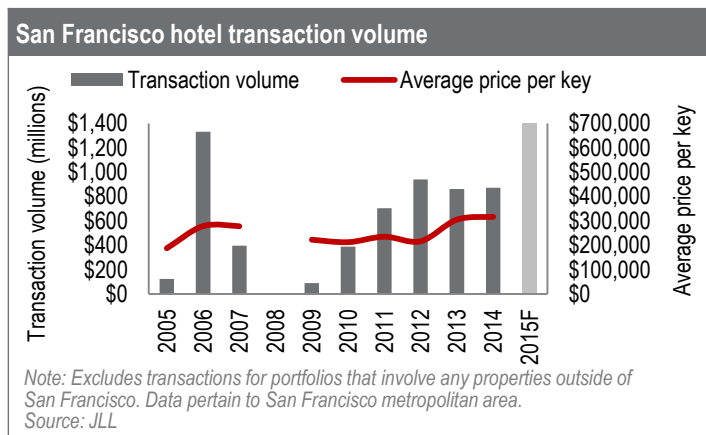
While the aforementioned factors present some downside risk for the San Francisco market, they are likely to result in softer growth than would otherwise be the case rather than any reversal in the region's growth trajectory. With the exception of California's drought, the duration and implications of which are difficult to predict, we expect that the other identified trends are likely to have minimal impact on lodging performance in San Francisco. Technology-based economic growth has remained strong in San Francisco despite competition from lower-cost markets thus far, and concerns regarding the implications of inventory constraints are predicated on continued strength in the market's lodging sector and the regional economy.

Most recently, transaction volume through May 2015 has been exceptional with over \$1.1 billion in hotel acquisitions due to blockbuster deals such as the sale of the Mandarin Oriental San Francisco for approximately \$1 million per key – significantly higher than the city's prior record of \$650,000 per key for the Hotel Vitale in 2014. Transaction activity has already surpassed last year's level of \$900 million less than halfway through the year. Surging demand growth due to booming economic activity in the context of limited supply growth given almost prohibitive development costs is contributing to soaring RevPAR and investor interest in the San Francisco market. Considering this environment and the volume of deals closed year-to-date, JLL anticipates that hotel transaction volume will surpass the prior 2006 peak level with hotel acquisitions totaling more than \$1.4 billion in 2015.

### Transaction volume continues to rise

Transaction activity has been strong over the past several years, exceeding \$900 million annually since 2012. Although transaction volume has not yet surpassed the previous peak reached in 2006,

REITs accounted for more than half of San Francisco hotel acquisitions in 2014 and have remained active in 2015, representing approximately one-third of buyers year-to-date. Hotel operators have also emerged as a strong buyer pool in 2015, with Hilton Worldwide and Loews Hotels acquiring properties to expand their footholds in the city. REITs and other long-term investors seeking high-quality assets in markets safeguarded with high barriers to entry are expected to continue targeting acquisitions in San Francisco going forward.



**San Francisco hotel transactions over \$100 million since 2013**

Contract Date	Property Name	Price	Rooms	Price per room	Buyer	Seller
Feb-15	Parc 55 San Francisco*	Undisclosed	1,024	Undisclosed	Hilton Worldwide	The Blackstone Group
Jan-15	Westin San Francisco Market Street	\$350,000,000	681	\$514,000	LaSalle Hotel Properties	Westbrook Partners, LLC
Dec-13	Hyatt Regency San Francisco	\$262,500,000	802	\$327,000	Sunstone Hotel Investors	Dune Real Estate Partners LP
Jul-13	The Ritz-Carlton, San Francisco	\$161,000,000	336	\$479,000	Thayer Lodging Group	Host Hotels & Resorts
Apr-15	Mandarin Oriental San Francisco	Undisclosed	158	Undisclosed	Loews Hotels and Resorts	GEM Realty Capital
Sep-14	JW Marriott Union Square	\$147,200,000	337	\$437,000	Chesapeake Lodging Trust	Thayer Lodging Group
Dec-13	Radisson Hotel Fisherman's Wharf*	\$132,000,000	355	\$372,000	Pebblebrook Hotel Trust	Square Mile Capital Management, LLC
Apr-14	Hotel Vitale	\$130,000,000	200	\$650,000	LaSalle Hotel Properties	Emerald Fund
Jun-2015	Best Western Plus the Tuscan	\$122,000,000	221	\$552,000	Pebblebrook Hotel Trust	Walnut Hill Capital
Feb-14	InterContinental Mark Hopkins	\$120,000,000	383	\$313,000	Woodridge Capital Partners	InterContinental Hotels Group
May-13	Hyatt at Fisherman's Wharf*	\$103,500,000	313	\$331,000	Chesapeake Lodging Trust	Hyatt Hotels Corporation

\*JLL acted as advisor to seller  
Source: JLL

## Market spotlight: Napa County

While the San Francisco lodging market is performing exceptionally well, other areas in the Bay Area are also experiencing profound growth. Napa County is a renowned tourist destination with high-end hotels and restaurants that complement the area's world-class wineries to fuel the region's economy. Napa County encompasses multiple towns including Napa, Calistoga and St. Helena, each with their own unique draw.

The region's strong tourism-based economy and its enviable proximity to San Francisco, with its booming economy and high concentration of wealth, have captured significant investor interest in recent years. Key trends that have shaped the market in recent years include the following:

### 1. Significant luxury hotel development

While some developments have stalled in the past, there is a notable pipeline of new luxury product, both in the form of new ground-up developments and the conversion and repositioning of existing properties. Notable conversions include the reopening of a hotel in St. Helena as Las Alcobas, a Luxury Collection Hotel by Starwood, and the redevelopment of Calistoga's Silver Rose Inn as a luxury resort. The VieVage, an Auberge resort located in Stanly Ranch, and the boutique Archer Hotel, situated in downtown Napa, are both new builds that are expected to enter the market over the next few years. Substantial entitled land also exists for new resort communities, which are likely to feature ample amenities and luxury positioning, such as the planned Calistoga Hills Resort in Napa Valley.

## Market spotlight: Silicon Valley

Silicon Valley is located in the southern portion of the San Francisco Bay Area, encompassing parts of the East Bay, the San Francisco Peninsula and San Jose. Given strong growth in the technology industry, the local lodging market has experienced substantial expansion. The following factors are driving hotel investment in Silicon Valley.

### 1. Booming technology industry

Offering the world's premier concentration of technology-oriented firms and requisite human capital, Silicon Valley has become a cradle for technology start-ups as well as home turf for traditional technology giants. Innovation has been a key aspect of the tech industry as large companies such as Apple and Google have created new products and services, while venture capital funds have funneled capital towards promising start-ups. As the tech expansion remains robust, demand for new office space and, in turn, hotel accommodations will continue to strengthen investment activity in Silicon Valley.

### 2. Double-digit RevPAR growth

The Silicon Valley lodging market has sustained five consecutive years of double-digit RevPAR growth. Strong RevPAR performance has been primarily fueled by ADR growth, though occupancy has also enjoyed an upward trajectory, approaching nearly 80% as of 2014. The market experiences especially robust mid-week demand given extraordinary levels of corporate demand from technology companies. Expect another year of double-digit RevPAR growth in 2015 driven by material ADR increases despite some new inventory coming online, as supply increases are being absorbed by rising demand.

### 2. Seven years of ADR growth

The Napa County lodging market has experienced seven consecutive years of ADR growth due to a strong tourism base and the delivery of luxury product. While the market lost considerable occupancy in the midst of the economic downturn in 2009, ADR growth did not waver. Since then, market-wide occupancy has recovered to 74% and average rates in the market have reached nearly \$250 as of 2014. Given continued delivery of luxury product, strength in regional tourism and healthy occupancy levels, RevPAR for Napa County is expected to increase in the range of 3% to 5% in 2015.

### 3. Premium pricing for key assets

Recent hotel transactions reveal that investors are willing to pay a strong premium for high-quality assets in key locations within Napa County. The high-profile Calistoga Ranch resort traded in 2013 at a record price of over \$1 million per room. In 2015, the recently announced Bardessono Hotel & Spa transaction is expected to set a new record at nearly \$1.4 million per key.

Hotel	Date	Rooms	Price	Price per key
Bardessono Hotel & Spa	pending	62	\$85,000,000	\$1,370,000
The Carneros Inn	Jun-14	86	\$62,500,000	\$727,000
Harvest Inn	Jan-14	74	\$55,000,000	\$743,000
Calistoga Ranch*	Nov-13	50	\$55,000,000	\$1,100,000
Andaz Napa	Sep-13	141	\$72,000,000	\$511,000
Fairmont Sonoma Mission Inn & Spa (75% Stake)	Jul-13	226	\$73,300,000	\$432,000

\*JLL acted as advisor to seller  
Source: JLL

### 3. Strong performance of non-luxury product

Given Silicon Valley's heavily corporate demand base – in contrast to Napa County's more leisure-oriented clientele – luxury positioning is not required to achieve strong performance in the market. Many select service hotels in Silicon Valley, especially those in close proximity to tech campuses, boast strong operating performance given limited supply and robust corporate demand. For example, among a set of select service hotels that derive demand from Apple's corporate campus, annual RevPAR growth averaged 14% from 2009 to 2014. Demand from Silicon Valley's corporate campuses is expected to further increase, with Facebook, Google and Apple all planning further campus expansions and headcount increases. To the extent hotel supply remains constrained, expect continued strength in RevPAR growth going forward.

*Luxury hotels comprise less than 5% of the Silicon Valley lodging market, compared to 40% of the Napa County market.*

The aforementioned factors are sparking significant investor interest in the market. However, given scarce acquisition opportunities, investors are gaining exposure to Silicon Valley primarily through new development opportunities. For instance, Related Companies is planning a massive mixed-use development near Levi's Stadium in Santa Clara, which will derive demand from several nearby tech campuses. The project is expected to include a 400-room business hotel, a 225-room Equinox hotel and a 150-room lifestyle branded hotel. Other projects include a planned 145-room Hyatt House and 180-room Residence Inn near Apple's campus in Cupertino as well as a 200-room aloft Hotel and 78-room Holiday Inn Express near Google's campus in Mountain View. The supply pipeline reflects the success of select service as well as lifestyle product offerings in the market.



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### About JLL's Hotels & Hospitality Group

JLL's Hotels & Hospitality Group serves as the hospitality industry's global leader in real estate services for luxury, upscale, select service and budget hotels; timeshare and fractional ownership properties; convention centers; mixed-use developments and other hospitality properties. The firm's more than 320 dedicated hotel and hospitality experts partner with investors and owner/operators around the globe to support and shape investment strategies that deliver maximum value throughout the entire lifecycle of an asset. In the last five years, the team completed more transactions than any other hotels and hospitality real estate advisor in the world totaling more than US \$48 billion, while also completing approximately 4,500 advisory, valuation and asset management assignments. The group's hotels and hospitality specialists provide independent and expert advice to clients, backed by industry-leading research.

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