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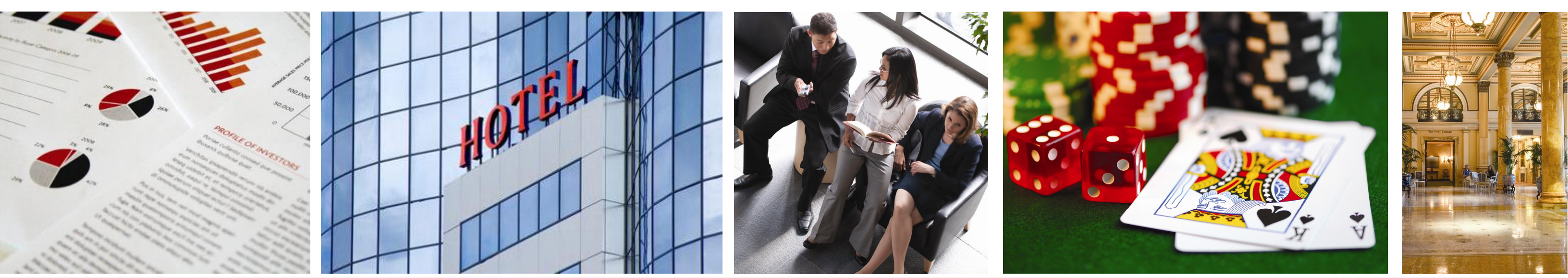
HVS HOTEL DEVELOPMENT COST SURVEY 2010

Elaine Sahlins
Senior Vice President,
HVS San Francisco Consulting & Valuation



HVS Consulting & Valuation | 100 Bush Street, Ste 750, San Francisco, CA 94104, USA

HVS Hotel Development Cost Survey 2010

Elaine Sahlins – January 2011

HVS has tracked hotel construction costs throughout the United States since 1976. The survey considers data for six lodging types: Economy/Budget Hotels, Midscale Hotels w/o F&B (without Food and Beverage), Extended-Stay Hotels, Midscale Hotels w/ F&B (with Food and Beverage), Full-Service Hotels, and Luxury Hotels and Independent Resorts. The 2009/10 hotel development survey reports updated per-room development costs for through the end of 2010.

Each year HVS Consulting and Valuation researches development costs from our database of actual hotel construction budgets, industry reports, and uniform franchise offering circulars. These sources provide the basis for our range of component cost per room. New project construction cost data collected each year may increase the range and/or impact the mean and median of the construction cost components. The upper and lower ends of the ranges are adjusted by changes in construction cost components derived from published sources and information from architects, contractors, developers, lenders, and other professionals involved with hotel development projects.

This year's development cost survey reflects actual ranges of development costs in each category. The survey is not meant to be a comparative tool to calculate changes from year to year but represents the true costs of building hotels across the United States. As with previous years' data, the data represent a wide variety of geographical locations from tertiary markets in the Southwest to mid-Manhattan. The development costs of the same hotel product, say a select-service Fairfield Inn or Holiday Inn Express, can be more than triple the amount from one locale to the other.

MAKING SENSE OF ALL THE DATA

By mid-2010, the construction industry was well into its third year of recession. Almost all segments of private construction were hit hard but as a ratio, the greatest contraction of commercial construction was in the lodging sector. The following chart shows the overall spending on construction in recent years including lodging, office, and commercial projects. These data show that while the value of hotel construction, as measured by the U.S. Census Bureau, represents less than four percent of the value of all private construction, the rate of decline in lodging development spending has experienced greater velocity than that for other commercial property types.

CHART 1 - CONSTRUCTION SPENDING – RESIDENTIAL AND COMMERCIAL

2002 THROUGH YTD OCTOBER 2010

Year	Residential	% Change	Lodging	% Change	Office	% Change	Commercial	% Change
2002	$4,752,501		$125,606		$424,562		$709,993	
2003	5,340,253	12 %	119,162	(5) %	367,104	(14) %	689,930	(3) %
2004	6,378,884	19	143,783	21	393,527	7	757,475	10
2005	7,326,331	15	151,990	6	448,207	14	798,911	5
2006	7,399,983	1	211,482	39	548,052	22	879,775	10
2007	5,943,074	(20)	329,767	56	645,519	18	1,025,596	17
2008	4,215,134	(29)	424,547	29	682,507	6	979,647	(4)
2009	3,035,288	(28)	300,391	(29)	488,200	(28)	653,672	(33)
YTD 10- 2009	2,516,498		264,753		424,590		565,188	
YTD 10- 2010	2,441,989	(3) %	114,057	(57) %	246,719	(42) %	386,378	(32) %

Source: US Census Bureau

Representative of the recent real-estate cycle, residential construction began to decline in mid-2007 and as of the fourth quarter 2010, has stabilized. Lodging, office, and commercial construction experienced downward trends later in the cycle. When development restarts for hotels, it is likely to be after the resumption of new office and commercial construction. Without lease commitments to provide financial certainty for new construction, the financing for new hotels is often undertaken during the later part a of real-estate recovery cycle, by which point in time other economic indicators are perceived by lenders to provide more assurance of a hotel's potential performance.

The slowdown in lodging construction has affected hotel product types from small budget properties to large destination resorts. When new hotel development resumes, it is likely to begin with those product types that are more easy to develop such as branded limited- and select-service hotels, and then larger and more complex projects will follow as the market strengthens.

SLOWDOWN IN THE HOTEL PIPELINE

From 2006 to 2010, hotel supply grew at a steady pace. As obtaining financing for new construction became more challenging in 2008, many projects were put on hold or cancelled. As seen in the following chart, the decline in the supply growth in 2010 is evidence of this change in the availability of debt. We expect that in 2011 the rate of new hotel rooms opening will decrease even further. Note that not all new rooms in each chain scale segment represent new construction; some room additions are from properties that were converted or rebranded, and may have upgraded or downgraded from other chain scale categories.

CHART 2 - NATIONAL HOTEL ROOM SUPPLY GROWTH – DECEMBER 2006 THROUGH NOVEMBER 2010

	Dec-06 Existing Supply	Dec-07 Existing Supply	Dec-08 Existing Supply	Dec-09 Existing Supply	Nov-10 Existing Supply	Total Change Dec 2006 to Nov 2010
Luxury	80,062	92,177	98,549	106,140	107,284	34.0 %
Change in rooms		12,115	6,372	7,591	1,144	
% Change		15.1 %	6.9 %	7.7 %	1.1 %	
Upper Upscale	539,457	542,321	566,449	591,029	598,736	11.0 %
Change in rooms		2,864	24,128	24,580	7,707	
% Change		0.5 %	4.4 %	4.3 %	1.3 %	
Upscale	406,932	455,309	485,768	530,143	553,081	35.9 %
Change in rooms		48,377	30,459	44,375	22,938	
% Change		11.9 %	6.7 %	9.1 %	4.3 %	
Midscale with F&B	534,063	518,019	506,814	507,005	497,317	(6.9) %
Change in rooms		(16,044)	(11,205)	191	(9,688)	
% Change		(3.0) %	(2.2) %	0.0 %	(1.9) %	
Midscale w/out F&B	694,594	729,289	774,938	823,694	840,837	21.1 %
Change in rooms		34,695	45,649	48,756	17,143	
% Change		5.0 %	6.3 %	6.3 %	2.1 %	
Economy	731,812	750,380	755,297	762,831	758,877	3.7 %
Change in rooms		18,568	4,917	7,534	(3,954)	
% Change		2.5 %	0.7 %	1.0 %	(0.5) %	
Independents	1,466,755	1,464,803	1,504,732	1,501,900	1,520,502	3.7
Change in rooms		(1,952)	39,929	(2,832)	18,602	
% Change		(0.1) %	2.7 %	(0.2) %	1.2 %	
Totals	4,453,675	4,552,298	4,692,547	4,822,742	4,876,634	9.5 %
Change in rooms		98,623	140,249	130,195	53,892	
% Change		2.2 %	3.1 %	2.8 %	1.1 %	

Source: Smith Travel Research

As of the third quarter of 2010, financing for existing hotels was beginning to return to the market, albeit at levels far below those that characterized the years prior to the current downturn. Typically, hotel development lending lags mortgages for acquisitions and refinancing. With hotel fundamentals recovering, investors are beginning to review stalled development projects. When financing is once again available for proposed hotels, supply growth can be expected to regain momentum. Due to the current dearth in available lending and the time required for new construction, we do not expect significant growth in new supply until at least 2012. This slowdown in new supply, however, is promising for continued occupancy and average rate and, hence, RevPAR recovery. In 2010, many markets had strong year-over-year occupancy growth over 2009 and some areas of the U.S. began to garner significant rate increases beginning in the second and third quarters of the year. Investors look to sustainable RevPAR as the first indicator that new hotels can be feasibly developed.

DEVELOPMENT COST CHANGES

During the prior lending cycle, land was a major form of collateral for construction lending and the price of well-located sites increased precipitously. In challenging real-estate investment periods, land is often the development component that experiences the greatest decline. A 2010 publication of the Federal Reserve that analyzed land prices in 23 MSAs across the United States described composite residential and commercial land prices increasing nearly 130.0% from 2002 to the second half of 2007. From the peak in 2007, land prices have decreased by more than 40.0%. The evidence of hotel land value declines is often more anecdotal than based on market evidence. In recent years, we have seen few land transactions as owners withdraw property from the market and hold on to sites - waiting for a time when development will once again generate financial returns.

HVS tracks the results of a number of construction surveys including data from the Turner Construction Index, the Engineering News Record, and the U.S. Bureau of Economic Analysis. Supply and demand trends continue to impact construction materials and labor costs. These sources report overall construction costs declines of 4.0% to 8.0% between 2008 and 2009. Industry sources vary on the change in construction costs in 2010. Some indicate declines of up to 4% while other report increases of almost 4.0%. In 2009 and 2010, the cost of a number of materials used in private commercial construction fluctuated from month to month, with many categories showing above-inflationary increases. Notably, the cost of structural steel increased 5.3%, lumber increased 15.0%, and plywood increased 7.0%. The improvement in lumber pricing is attributed to the continued strong demand from China. Beginning in mid-2008, Russia, China's former major source of lumber, increased the lumber tax by 25.0%.

Labor costs have been affected by different influences in the past 18 months. Union wage and benefit settlements have seen average increases of approximately 3.0%. However, with the decline in overall construction, contractors began diversifying their practices and engaging in a wider variety of product types and improving work practices and efficiencies. Despite the relatively recent uptick in contracting, industry participants report no consistency in bidding. Requests for proposals often receive a wide range of bids for the same project. For specialized hotel contractors, renovations have made up a majority of projects since 2009.

In the past few years, FF&E costs have decreased as purchasing agents have negotiated substantial discounts with vendors on many items. Other FF&E costs have not been as impacted; the costs of wood furniture and fabrics have remained high. By 2012, most FF&E costs are anticipated to increase back to 2007 levels. As with our prior survey, fewer development projects mean fewer construction services. Categories such as public agency fees have not declined, although decreases in tax assessments and professional fees have moderated soft costs to a degree.

Green building remains a new-hotel construction objective but only a small portion of proposed hotels are being developed to meet LEED certifications. New construction is primarily emphasizing more efficient energy system design and operations rather than the wholesale use of green building materials and construction methods.

With the improvement in the hotel fundamentals in 2010, planning for new hotel construction is gaining momentum. Once again, hotel construction is expected to compete with other real-estate development and, by the end of 2011, the costs for most materials are forecast to be higher due to continuing strong demand internationally. Although lending rates are relatively moderate at this time, the availability of new financing for hotel development will continue to be a pivotal factor in propelling the pipeline of increased hotel construction.

PER-ROOM HOTEL DEVELOPMENT COSTS

Consistent with the last survey, lower costs in the 2009/10 development cost survey have the greatest impact on the land and building improvements. Other categories, as shown in the following table, are not as volatile.

CHART 3 - 2010 HOTEL DEVELOPMENT COST SURVEY PER-ROOM AVERAGES (BASED ON 2009/10 AMOUNTS)

	Land	Building and Site Improvements	Soft Costs	FF&E	Pre-Opening and Working Capital	Total
Budget/Economy Hotels						
Average from Budgets	$11,700	$50,800	$4,400	$8,100	$3,000	$65,200
Median	$11,200	$46,200	$2,200	$8,100	$2,900	$52,700
Allocation	14%	66%	10%	11%	4%	
Midscale Hotels w/o F&B						
Average from Budgets	$23,400	$71,400	$11,100	$9,500	$4,100	$98,000
Median	$12,200	$63,100	$8,100	$9,200	$2,800	$82,100
Allocation	14%	68%	9%	10%	4%	
Extended-Stay Hotels						
Average from Budgets	$12,200	$79,000	$11,300	$12,600	$3,300	$131,600
Median	$10,900	$69,300	$9,900	$13,000	$2,400	$105,500
Allocation	12%	68%	9%	12%	4%	
Midscale Hotels w/ F&B						
Average from Budgets	$13,900	$76,800	$13,200	$12,000	$3,800	$117,300
Median	$10,200	$63,300	$10,400	$11,300	$3,000	$100,600
Allocation	13%	65%	11%	12%	3%	
Full-Service Hotels						
Average from Budgets	$16,800	$122,900	$22,200	$22,000	$6,900	$208,100
Median	$13,200	$111,600	$14,000	$18,100	$5,700	$156,200
Allocation	12%	64%	12%	12%	4%	
Luxury Hotels and Resorts						
Average from Budgets	$86,700	$345,700	$133,800	$54,000	$20,800	$598,500
Median	$88,600	$299,800	$88,600	$57,700	$18,700	$538,200
Allocation	17%	59%	14%	10%	4%	

Source: HVS

CHART 4 - HOTEL DEVELOPMENT COST SURVEY PER-ROOM RANGE OF COSTS FOR 2010

2010	Land			Building and Site Improvements			Soft Costs			FF&E			Pre-Opening and Working Capital			Total		
Budget/Economy Hotels	$3,700	-	$25,800	$31,000	-	$97,300	$600	-	$13,000	$4,500	-	$16,600	$1,400	-	$7,100	$40,100	-	$143,800
Midscale Hotels w/o F&B	3,600	-	73,100	46,400	-	173,900	2,100	-	61,200	5,500	-	25,600	900	-	25,700	60,800	-	389,400
Extended Stay Hotels	2,200	-	39,400	52,700	-	163,700	2,300	-	84,200	3,500	-	23,800	700	-	25,300	71,200	-	270,300
Midscale Hotels w/ F&B	3,300	-	54,500	46,700	-	150,300	3,400	-	63,100	6,700	-	36,300	300	-	18,900	74,700	-	302,700
Full-Service Hotels	3,500	-	100,100	62,000	-	357,300	2,300	-	118,300	8,400	-	53,500	1,900	-	85,500	97,100	-	591,500
Luxury Hotels and Resorts	12,200	-	222,800	183,800	-	1,411,600	24,800	-	229,400	33,700	-	119,500	10,400	-	80,600	415,400	-	1,481,600

Source: HVS

It is important in this analysis to note that there is no uniform system of allocation for hotel development budgets. Hotel development costs are accounted for in numerous line items and categories. Individual accounting for specific projects can be affected by tax implications, underwriting requirements, and investment structures. For example, in a development project, furniture, fixtures, and equipment installation and construction finish work can overlap. Accounting for these items is not always the same from one project to another.

In addition, we recommend that users of the HVS Consulting and Valuation Development Cost Survey consider the per-room amount in the individual cost categories only as a general guide for that category. The totals for low and high ranges in each cost category do not add up to the high and low range of the sum of the categories. None of the data used in the survey showed a project that was either all at the low range of costs or all at the high range of costs. A property that has a high land cost may have lower construction costs and higher soft costs. The total costs shown in the preceding table are from per-room budgets for hotel developments and are not a sum of the individual components.

All individual property information used by HVS Consulting and Valuation for the development cost survey is provided on a confidential basis and is believed to be reliable. Data from individual sources are not disclosed.

About HVS

HVS is the world's leading consulting and services organization focused on the hotel, restaurant, shared ownership, gaming, and leisure industries. Established in 1980, the company performs more than 2,000 assignments per year for virtually every major industry participant. HVS principals are regarded as the leading professionals in their respective regions of the globe. Through a worldwide network of 30 offices staffed by 400 seasoned industry professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. For further information regarding our expertise and specifics about our services, please visit www.hvs.com.

About the Author

Elaine Sahlins holds an undergraduate degree from Barnard College, Columbia University in New York City and an MPS degree in Hotel Administration from Cornell University. After graduating from Cornell she worked for VMS Realty in Chicago analyzing hotel investments, and then went on to become a review appraiser in San Francisco at Security Pacific, which was subsequently acquired by Bank of America. She joined HVS in 1997 in the San Francisco office. Elaine assumed responsibility for the Hotel Development Cost Survey in 1998.

For further information, please contact Elaine by email at esahlins@hvs.com, or by telephone at +1 (415) 268-0347.

HVS Consulting & Valuation | 100 Bush Street, Ste 750, San Francisco, CA 94104, USA