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HVS HOTEL DEVELOPMENT COST SURVEY 2011/12

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HVS Hotel Development Cost Survey 2011/12

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 2011/12 hotel development survey reports updated per-room development costs through the end of 2011.

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 also consider changes in construction cost components derived from published sources, industry indexes, 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 costs of building hotels across the United States. As in previous years' data, the data represent a wide array 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.

Build or Buy?

In 2011, we saw continued momentum in the buying and selling of hotels but little traction in new hotel construction. New hotel construction increases when two factors occur concurrently: hotel operating fundamentals are strong and reasonably priced financing for new construction is readily available. Hotel fundamentals continue to improve, aided by the lack of significant new supply over the past several years. The occupancy levels of many hotel markets have fully recovered, leading the way for strong ADR growth. Hotel net income in strong markets has or will soon reach the level necessary to support new development of certain lodging products. However, many markets continue to lag the recovery and will not be supportive of new hotel development for several years. While developers in strong markets look to finance their projects, favorably priced debt for new projects has remained scarce. In the current environment, active hotel lenders are more likely to provide acquisition or refinancing loans for operating hotels with a proven net operating income history than construction financing for proposed projects. Debt is selectively available on feasible projects with strong sponsors at loan-to-value ratios in the 50% to 60% of cost range, creating a need to raise significant amounts of equity for new projects. Those seeking financing are reaching out to other sources than traditional lenders such as debt REITs, private debt funds, and EB-5 programs. The EB-5 program allows investors with a minimum investment of \$500,000 to \$1,000,000 depending on the area, to receive a visa for a two-year residency which can be converted into a green card if the investment generated at least 10 jobs. Sourcing financing for development projects remains challenging in the current environment.

Despite the strong improvement in operating fundamentals, the volume of new hotel construction remains below the peak. Consistent with the trends in recent years the overall spending on private-commercial construction including lodging, office, apartments, and retail projects, continued to decline. As reported by the U.S. Census Bureau, the overall expenditure volume of new hotel construction projects was down 19.0% from November 2010 to November 2011. In a recent *Engineering News Report Construction Industry Confidence Index*, only 19% of those surveyed perceived the current outlook for

hotel construction to be improving. However, rays of hope are appearing: 25% of respondents expected improvement in the next 3 to 6 months, while 44% anticipated improvement in the next 12 to 18 months.

A third consideration also motivates hotel developers: that building a new hotel will offer a better investment opportunity than buying an existing asset. At this point in the cycle, some hotels are beginning to sell for below replacement cost in denser urban and suburban areas. However, older hotels, particularly those suffering from obsolescence, and those located in weaker secondary and tertiary markets fall in this category are selling below replacement costs. Some investors are seeking opportunistic opportunities to acquire these assets at favorable prices and improve their value with renovations, refurbishment and repositioning strategies rather than pursue new construction.

.Despite these challenging factors for new construction, hotel development is being sought in strong markets. The pipeline of proposed hotel projects increased in 2011. The new hotel projects are predominantly select-service and extended-stay properties located in markets with relatively low barriers to entry.

Hotel room inventory data from Smith Travel Research (STR) show the recent national trends in new hotel supply, as reflected in the following chart.

CHART 1 - NATIONAL HOTEL ROOM SUPPLY GROWTH – DECEMBER 2009 THROUGH NOVEMBER 2011

	Dec-09 Existing Supply	Dec-10 Existing Supply	Nov-11 Existing Supply	Total Change Dec 2009 to Nov 2011	Nov-11 In Construction Pipeline	Nov-11 Total Active Construction
Luxury	120,172	124,432	122,729			
Change in rooms		4,260	(1,703)		1,657	5,910
% Change		3.5 %	(1.4) %	2.1 %	1.4 %	4.8 %
Upper Upscale	538,632	547,641	553,823			
Change in rooms		9,009	6,182		7,212	19,926
% Change		1.7 %	1.1 %	2.8 %	1.3 %	3.6 %
Upscale	548,013	565,702	570,948			
Change in rooms		17,689	5,246		16,140	78,301
% Change		3.2 %	0.9 %	4.2 %	2.8 %	13.7 %
Upper Midscale	757,186	770,438	823,252			
Change in rooms		13,252	52,814		16,325	86,539
% Change		1.8 %	6.9 %	8.7 %	2.0 %	10.5 %
Midscale	577,227	564,674	511,811			
Change in rooms		(12,553)	(52,863)		2,954	26,346
% Change		(2.2) %	(9.4) %	(11.3) %	0.6 %	5.1 %
Economy	785,464	784,264	788,230			
Change in rooms		(1,200)	3,966		878	3,606
% Change		(0.2) %	0.5 %	0.4 %	0.1 %	0.5 %
Independents	1,482,111	1,495,001	1,520,502			
Change in rooms		12,890	25,501		9,133	89,568
% Change		0.9 %	1.7 %	2.6 %	0.6 %	5.9 %
Totals	4,808,805	4,852,152	4,891,295			
Change in rooms		43,347	39,143		54,299	310,196
% Change		0.9 %	0.8 %	1.7 %	1.1 %	6.3 %

Source: Smith Travel Research

In the past two years, new hotel supply equated to less than one percent of all hotel rooms tracked by STR. This can be compared to a prior cycle peak of 3.5% supply growth in 2008. Some of the supply inventory changes between December 2009 and November 2011 were conversions from one category to another and changes within levels of related brands such as property upgrades from Best Western to Best Western Plus. With the lack of available financing for new hotel construction for the past three years, the pipeline of new hotels under construction remained constrained at roundly 1.1% of the existing supply. Other planned supply appeared to be more robust in all categories; however, with construction loans still scarce the probability of all of these new rooms opening as planned remains speculative. The timetable for a number of these projects will likely be extended.

Development Cost Changes

Land transactions intended for hotel construction continued to be few and far between. As with existing hotel assets for sale, the owners that were able to do so withdrew their sites from the market if they did not achieve their desired pricing. With little available financing for new hotel construction, land transactions stagnated. Discussions with market participants indicate that land values in 2011 were unchanged from 2010 for well-located sites and declined modestly more difficult development projects. As of the second half of 2011, desirable building sites for apartment and commercial development in major urban areas are just starting to transact. Until more financing is available for hotel construction, hotel site values are not expected to appreciate significantly.

For materials and labor construction costs, industry surveys and development budgets indicate generally inflationary growth when compared to 2010. The cost of some materials fluctuated with international demand, particularly from China. Most private construction was still stagnant in the US, but overseas and public projects continued to increase putting pressure domestically on prices for some material. Contrary to 2010, lumber prices stabilized. The lumber industry in 2011 was reportedly running at 70% capacity even after numerous mills closed. Gypsum product prices decreased by 2.7%, while structural steel and sheet metal costs increased by over 5.0%.

As in 2010, renovations continued to drive a large portion of the hotel construction trade. In 2011, these projects and new ground-up development were affected by the increase in wages and benefits, and worker's compensation insurance costs. Construction industry surveys report labor and related cost increased from 2.0% to 3.8% in 2011. In the past few years, FF&E costs decreased as purchasing agents negotiated substantial discounts with vendors. The lower demand for FF&E items in recent years resulted in reduced inventories and staff reductions by manufacturers and suppliers. Demand is now improving, affecting pricing for some items, particularly fabrics. Transportation costs, which factor in FF&E pricing, also increased with higher fuel prices. In 2011, FF&E costs were moderately higher than in 2010. Hotel renovation projects are expected to ramp up in 2012 and 2013 and the cost of materials and wait times are also projected to increase as many brands impose upgrades to be compliant with standards, requirements that were waived or postponed in prior years.

While the number of new hotel rooms opening has moderated, property design trends have continued to change. Hotel prototypes are more efficiently designed. New space programs include common multipurpose areas that incorporate time- and energy-saving food and beverage technology. These multipurpose layouts also allow staff to be cross-trained for leaner payrolls. Green building construction continues to be a mantra for new hotel development, although building sustainable hotels is costlier than traditional construction.

Per-Room Hotel Development Costs

The nadir of hotel development costs in the most recent cycle was 2010. Costs in most categories increased at or slightly below inflation, with the exception of land, which continued to be impacted by the lack of general development activity.

CHART 2 - 2011 HOTEL DEVELOPMENT COST SURVEY PER-ROOM AVERAGES (BASED ON 2010/11 AMOUNTS)

2011	Land	Building and Site Improvements	Soft Costs	FF&E	Pre-Opening and Working Capital	Total
Budget/Economy Hotels						
Average	\$11,100	\$52,300 #	\$4,400 #	\$8,300 #	\$3,000 #	\$67,200
Median	\$10,600	\$47,600 #	\$2,200 #	\$8,300 #	\$2,900 #	\$54,300
Allocation	14%	66%	10%	11%	3%	
Midscale Hotels w/o F&B						
Average	\$22,200	\$73,500 #	\$11,100 #	\$9,800 #	\$4,100 #	\$100,900
Median	\$11,600	\$65,000 #	\$8,100 #	\$9,500 #	\$2,800 #	\$84,600
Allocation	14%	67%	10%	10%	5%	
Extended-Stay Hotels						
Average	\$12,200	\$81,400 #	\$11,300 #	\$13,000 #	\$3,300 #	\$135,500
Median	\$10,900	\$71,400 #	\$9,900 #	\$13,400 #	\$2,400 #	\$108,700
Allocation	12%	67%	9%	12%	4%	
Midscale Hotels w/ F&B						
Average	\$13,900	\$79,100 #	\$13,200 #	\$12,400 #	\$3,800 #	\$120,800
Median	\$10,200	\$65,200 #	\$10,400 #	\$11,600 #	\$3,000 #	\$103,600
Allocation	13%	65%	11%	12%	3%	
Full-Service Hotels						
Average	\$15,500	\$125,400 #	\$22,200 #	\$22,700 #	\$6,900 #	\$212,300
Median	\$12,100	\$113,800 #	\$14,000 #	\$18,600 #	\$5,700 #	\$159,300
Allocation	12%	64%	12%	12%	4%	
Luxury Hotels and Resorts						
Average	\$79,800	\$356,100 #	\$133,800 #	\$55,100 #	\$20,800 #	\$610,500
Median	\$81,500	\$308,800 #	\$88,600 #	\$58,900 #	\$18,700 #	\$549,000
Allocation	17%	59%	14%	10%	4%	
Source: HVS						

CHART 3 - HOTEL DEVELOPMENT COST SURVEY PER-ROOM RANGE OF COSTS FOR 2010

2011	Land		Building and Site Improvements		Soft Costs		FF&E		Pre-Opening and Working Capital		Total	
Budget/Economy Hotels	\$3,700	- \$25,800	\$31,900	- \$100,200	\$600	- \$13,000	\$4,600	- \$17,100	\$1,400	- \$7,100	\$40,900	- \$146,700
Midscale Hotels w/o F&B	\$3,600	- \$73,100	\$47,800	- \$179,100	\$2,100	- \$61,200	\$5,700	- \$26,400	\$900	- \$25,700	\$62,000	- \$397,200
Extended Stay Hotels	\$2,200	- \$39,400	\$54,300	- \$168,600	\$2,300	- \$84,200	\$3,600	- \$24,500	\$700	- \$25,300	\$72,600	- \$275,700
Midscale Hotels w/ F&B	\$3,300	- \$54,500	\$48,100	- \$154,800	\$3,400	- \$63,100	\$6,900	- \$37,400	\$300	- \$18,900	\$76,200	- \$308,800
Full-Service Hotels	\$3,400	- \$95,100	\$63,200	- \$364,400	\$2,300	- \$118,300	\$8,600	- \$54,600	\$1,900	- \$85,500	\$98,100	- \$597,400
Luxury Hotels and Resorts	\$11,800	- \$211,700	\$187,500	- \$1,270,400	\$24,800	- \$229,400	\$34,400	- \$121,900	\$10,400	- \$80,600	\$419,600	- \$1,496,400
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.

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