



RUSHMORE

IT'S TIME TO DEVELOP NEW HOTELS

It amazes me during this economic downturn—when hotel values have in some areas declined 50 percent or more and existing properties can be purchased at bargain prices—that hundreds of hotel developers all over the world are still looking to build new projects. In fact, HVS has never been busier performing feasibility studies for these developers to evaluate.

Why build new at what would equate to replacement cost when you can buy an existing hotel at 33 to 50 percent of replacement cost? There are plenty of reasons.

Ever since the financial collapse, which occurred at

companies facing a dearth of new business are much more accommodating during their approval process. In some instances they are even providing financing, reduced fees and more favorable contract provisions.

The biggest benefit of starting a new hotel development now is the actual construction cost savings. Since we are in a global recession, which adversely affects the entire world, the cost of building supplies, equipment and contractors' profit have fallen significantly. For example, during 2008 lumber prices dropped eight percent and for the 12 months ending in July 2009, prices declined another 10 percent. The price of steel was up 12.5 percent in 2008, but for the 12 months ending in July 2009 it was down 15.3 percent. Copper and aluminum were both lower in 2008 (minus 24.2 percent and minus 2.8 percent, respectively). With the lack of new

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the end of 2007, construction financing for new hotel projects has been very difficult to obtain. To get a new hotel built, developers need a very close relationship with a lender. They often have to personally guarantee the loan, and in most cases, financing is limited to the smaller, mid-scale hotel developments. Loans for large five-star projects are practically impossible. The result of this illiquidity is a drastic decline in the development pipeline, which is expected to continue for the next three to five years.

We are finding that proposed hotel projects are now facing a much different opening landscape. In the past, it was very difficult to predict future supply growth and what the competitive environment would look like for the property upon opening. Today, it is unlikely that any new hotels will get built over the short-term so the present supply picture is likely to remain status quo. This significantly reduces risk of over-supply upon opening.

HVS has found that developing a new hotel at the bottom of this cycle has gotten significantly easier. Land values have declined 25 to 50 percent in some markets, which is an immediate savings for a developer. Municipalities seem to be granting approvals quicker and in some instances giving incentives to encourage new development. The hotel brands and management

construction financing continuing for the foreseeable future, demand for construction material will remain low and further price declines are likely.

HVS tracks hotel development costs and publishes its Hotel Development Cost Survey each year. Between 2007 and 2008/09, the survey shows a decline in total hotel development cost ranging from 10 to 16 percent. This reverses many years of rising costs and the outlook for the future is continued declines.

Developing hotels is a risky business. However, at this point in time, many of the risk factors such as competition from other new developments, continually rising development budgets and cost over-runs and the lack of interest for hotel brands have been significantly reduced. If you are able to finance a hotel project today and start construction, it should open in a much-improved economic environment and as the new kid on the block, it should capture more than its fair share of the market.

* **Stephen Rushmore** is president and founder of HVS, a global hospitality consulting organization with offices around the world. Steve has provided consultation services for more than 12,000 hotels throughout the world during his 35-year career and specializes in complex issues involving hotel feasibility, valuations, and financing. He can be reached at srushmore@hvs.com or 516 248-8828 ext. 204.