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MARKET REPORT

HVS Monday Musings: Hotel Development Feels the Heat of Rising Input Costs

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> The Indian hotel sector is reeling under the pressures of rising input costs, which is affecting not only operations but also hotel development plans. Read on to know more.

The Indian hotel sector is finally breathing a sigh of relief as demand has recovered dramatically in recent months, even helping push occupancy and average rates closer to pre-pandemic levels in a few markets. However, the hotel sector, like most others, is reeling under the pressures of rising prices, affecting not only operations but also hotel development plans in the country.

The construction industry as a whole has been hit hard by rising prices for essential building materials like steel and cement, as well as rising labor costs due to skilled labor migration and rising transportation costs owing to the constant increases in fuel prices. Recent industry reports suggest that building materials prices have risen by 30-50% in the last year, resulting in a sharp rise in overall real estate development costs. Unlike other real estate asset classes such as residential, offices space, and warehouses, where developers can pass on a portion of the rising costs to customers, hotel developers must absorb all of the costs and cannot pass even a fraction of the development costs to guests. This will have a ripple effect on the hotel sector, resulting in more project delays and postponements, as well as increased financial stress for developers, especially with lenders putting the hotel sector on the back burner and the present low sector performance compounding the problems.

In any case, hotel supply growth was limited in 2020, as several projects were delayed, deferred, or put on hold due to the pandemic-related restrictions. Only 4,537 keys entered the branded space in 2020, far less than the 15,000 keys projected for the year before the pandemic. The situation seems to be improving in 2021, as over 4,400 keys have been opened in the first nine months of the year. Despite the higher growth in 2021, the aggregate supply of 2020 and 2021 still falls short of the pre-pandemic estimates and the rising construction costs are not helping matters.

With rising input costs, hotel developers have a compelling reason to consider and adopt alternative construction methods like prefabrication and modular construction. These methods are not new, and several international hotel chains, such as Marriott, Hilton, Accor, and CitizenM are increasingly adopting them for their global projects. Even luxury hotels are being developed utilizing prefab and modular technology because of the vast range of benefits they provide, including shorter development timeframes, reduced construction costs, and greater sustainability.

In India, however, most developers, except for a few in the economy segment, are still wary of these novel construction methods, owing to a lack of awareness of the benefits and perception of design restrictions. With technology advances, prefab and modular construction can now provide greater customization in project designs and can be used for a wider range of projects than before, which is likely to increase its acceptance in India. The rising construction costs are also likely to help correct the perennial problem of overbuilding and overspending on hotels in India, as building efficiently designed hotels at the right cost and the right leverage will be critical in the post-COVID world.