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HOTEL DEVELOPMENT COST SURVEY 2013/14

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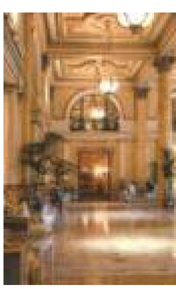

HVS has tracked hotel construction costs throughout the United States since 1976. Each year, HVS Consulting & Valuation researches development costs from our database of actual hotel construction budgets, industry reports, and uniform franchise offering circulars. These sources provide the basis for our range of component costs per room.

This 2013/14 survey reports updated per-room hotel development costs through the end of 2013, and considers data for six lodging types:

- Economy/Budget Hotels,
- Midscale Hotels without Food and Beverage (w/o F&B),
- Extended-Stay Hotels,
- Midscale Hotels with Food and Beverage (w F&B),
- Full-Service Hotels, and
- Luxury Hotels and Independent Resorts.

In the HVS Hotel Development Cost Survey, the elements of a hotel development budget are broken down into five general categories: Land; Construction Costs and Site Improvements; Soft Costs; Furniture, Fixtures, and Equipment (FF&E); and Pre-opening and Working Capital. These categories provide general ranges for analyzing and developing hotel development budgets on a per-room basis. The classifications are broad enough for professionals with different expertise to work with and understand.

New-project construction cost data collected may increase the range and/or affect 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 and 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—rather, it represents the true costs of building hotels across the United States. As in previous years, 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.

NEW HOTEL SUPPLY

By the end of 2013, the hotel investment market as a whole had largely recovered from the recessionary years of 2008 through mid-2010, but the trend in market-by-market hotel development has been uneven. As in other cyclical recoveries, coastal and major destinations have fared better than many secondary and tertiary locations. In the past two years, the hotel fundamentals of stronger markets have improved to the point where the value of existing properties may be at or near the replacement cost, supporting an increase in new hotel construction. Yet in these same markets, particularly in urban areas, new hotel development may still be constrained. Hotels are usually not the first real estate class to ramp up development in an economic recovery—housing is typically the lead product to emerge. In the current environment, rental apartment and condominium projects in strong, mostly urban markets are being proposed for desirable sites. These projects are vying with hotel projects for those same sites, curbing the ability of hotel developers to find land to develop in many urban markets. Conversely, markets that may not be as robust as major urban centers but which can support lower density development are seeing new hotel supply growth. The competition for well-located sites and other high barriers to entry, such as entitlement and construction costs, in primary markets is driving developers to seek out projects in secondary and tertiary markets. As a result, much of the proposed hotel inventory we are seeing is in non-primary markets.

Consistent with the last cycle, construction of limited- and select-service, and extended-stay hotels has led the pack, with rooms in the STR Upper Midscale, and Upscale chain scales accounting for over 50% of all proposed hotel rooms. These two chain scale categories include major franchised brands such as Courtyards, Hampton Inns, Holiday Inn Express, and others. The typically less complex and shorter construction process and the more profitable operating performance of these products (compared with those of full-service hotels) provide greater incentives for developers, brands, operators, and lenders. The construction momentum of these products is supported by the increasing availability of project financing.

Because of the interest in development in secondary and tertiary markets, the velocity of proposed hotel rooms nationally is increasing. According to the November 2013 STR Pipeline Outlook, over 91,000 hotel rooms are currently under construction with 228,000 in the planning and final planning stages. Looking back to the same report for December 2008, over 185,000 hotel rooms were under construction with almost 430,000 in the planning and final planning stages. So while there is an increased level of proposed hotels across the country than in the past five years, the current hotel development pipeline is nowhere near the prior peak levels.

THE IMPORTANCE OF NEW HOTEL SUPPLY

As the majority of new hotel development continues to be select-service hotels, we are seeing a resurgence of full-service hotel projects underway as part of larger redevelopments planned with some public financial support. With the recovery firmly underway, full- and select-service hotel projects that are expected to offer economic benefits to local areas are proposed or under construction. New hotels are being actively pursued with public subsidies to bridge feasibility gaps, in both large and small cities across the US such as Cleveland, OH; Harrisburg, VA; Philadelphia, PA; Evansville, IN; Frederick. MD; Garden Grove City, CA; Madison, WI; and Minneapolis, MN. These public-private partnerships help to facilitate the construction of less traditionally feasible full-service hotels, and are often associated with existing or proposed convention centers or are intended to be catalysts for greater area redevelopment.

The volume of hotel construction is increasing, however, the opening of new hotel rooms is not the only factor impacting the US hotel inventory. Conversions of properties from one brand to another, hotel expansions and hotel closings all contribute to dynamic supply trends. It is important to consider the net change in the number of hotel rooms, not just new construction, when evaluating the impact of new supply. The following chart illustrates the net changes in the US hotel supply since November 2008.

EXHIBIT 1: CHANGES IN THE INVENTORY OF US HOTEL ROOMS 2008-2013

	Existing Hotel Rooms November 2008	New Build/ Expansion	New Build as a % of Existing Rooms	Existing Hotel Rooms November 2013	Net Change 2008 to 2013	New Build to Net Change (Hotel Room Gain/Loss)	Lost Inventory as a % of New Rooms	Net Supply Change
Luxury	91,026	15,034	16.5 %	107,140	16,114	1,080	7.2 %	17.7 %
Upper Upscale	522,344	30,617	5.9	562,060	39,716	9,099	29.7	7.6
Upscale	487,850	102,625	21.0	611,168	123,318	20,693	20.2	25.3
Upper Midscale	758,436	137,274	18.1	873,621	115,185	(22,089)	(16.1)	15.2
Midscale	520,428	41,423	8.0	475,646	(44,782)	(86,205)	(208.1)	(8.6)
Economy	771,657	25,012	3.2	769,897	(1,760)	(26,772)	(107.0)	(0.2)
Unaffiliated	1,501,987	48,874	3.3	1,534,485	32,498	(16,376)	(33.5)	2.2
Totals	4,653,728	400,859	8.6 %	4,934,017	280,289	(120,570)	(30.1) %	6.0 %

Source: Smith Travel Research

With the caveat that the most recent five years represent a period of relatively contracted new hotel construction, the above trend shows that tracking only newly constructed hotel rooms does not tell the complete story of the changes in hotel supply. Hotels inventory in the lower tiers of the product categories actual declined over the past five years while the upper end of hotels gained in number of rooms. The gains and losses in hotel rooms shown in the preceding chart reflect a variety of events. Individual properties are converted from one brand to another. Hotels may expand or contract their existing inventory. As a hotel market matures, older, obsolete properties are removed from inventory. In fact, in the last five years, the loss in hotel rooms equates to approximately 30% of the newly built hotel rooms during that period. While supply trends may vary across markets, new hotel construction is critical to maintaining an updated national hotel inventory. As the US hotel market loses rooms, some new supply is needed to replace lost rooms.

CONSTRUCTION COST TRENDS

For all building sectors, the overall volume of commercial construction in 2013 was greater than in 2012. According to McGraw Hill, during the first 11 months of 2013, nonresidential building climbed 8% relative to the same period a year ago. Commercial categories as a whole were up 16%: warehouses +32%, hotels +24%, office buildings +23%, and retail +1%. Housing development is the largest sector of the construction industry and can readily affect materials costs. Residential construction volume was 25% higher in 2013 than in 2012. While the pace of housing (and commercial) construction is increasing, the volume of put-in-place construction costs is not near pre-recession levels.

As hotel market performance continues to improve, securing prime hotel sites requires larger initial investments. With the competition from other real estate projects, good sites are selling for significantly more than in the past five years. Good sites in urban markets with high barriers to entry are available but too expensive to develop profitably; most hotels are being built in secondary and tertiary markets where land prices increased during 2013 but generally not by double-digit levels.

The price of primary construction materials such as lumber and gypsum board was higher in 2013 than in 2012, but because of fluctuations in the volume and timing of projects over the year, costs were volatile. This instability is mirrored by the American Institute of Architect's (AIA) billing index which swung almost 100% from month-to-month during 2013. The AIA reports that, although the number of projects notably increased in 2013, projects are taking longer to come to fruition and clients are as cost conscious as ever. Adding to the shift in costs is the increasingly global sourcing of materials. Supply and demand influences are magnified by the challenges of procuring materials due to changes in global availability, pricing, quality, and delivery.

For contractors bidding on projects, jobs can be won or lost due to labor costs. Labor costs—another major component of development—are increasing, fueling concern among development professionals. Union contracts were largely negotiated to reflect inflationary increases in 2013, but benefit costs are growing at a greater rate and constrain the actual wages paid to workers. In addition, with the increase in construction projects, highly skilled subcontracting labor is in relatively short supply.

Given the rise of labor and material costs and the fact that the volume of new-construction work has not fully recovered, material suppliers and construction companies continue to hone their business models to improve efficiencies. Project estimation and management have evolved significantly over the past 10 years through the use of technology. With increased prefabrication of components by subcontractors off-site and the proliferation of internet-based mobile tablets on site, construction is being done with greater accuracy and more controlled scheduling. The use of Building Information Modeling (BIM) software also achieves cost containment. Architects and designers produce a virtual project electronically during the initial project phases, and can thus generate real-time estimates of costs. Construction industry professionals recognize that the majority of changes and problems can be avoided through good communication and stakeholder meetings, bringing in all the players to provide input at the start of the project. Electronic plans are becoming the norm, with many cities offering permits based on online submissions. Many architects, contractors, and developers are working toward a paperless construction process.

Financing new projects remains as important as supply and demand for hotel construction. Interest rates remained low through most of 2013 and are expected to remain moderate. Given the still relatively low cost of construction financing, the primary issue for hotel developers is availability of funds. In our practice, we are seeing more financing for new hotel construction now than in the past five years. During 2013, HVS was involved with approximately 450 assignments for proposed hotel construction in the US, including market studies and appraisals. This represents an almost 30% increase over our volume of consulting and appraisal assignments for new US hotels in 2012.

HOTEL DEVELOPMENT COST CATEGORIES

The Uniform System of Accounts for Hotels provides industry participants with a common language for analyzing the financial performance of a hotel. While the American Institute of Certified Professional Accounts methods are prescribed for construction accounting, when reviewing a development budget for feasibility, a consistent format is woefully lacking. As consultants preparing market and feasibility studies or as appraisers developing opinions of value for construction financing, we have reviewed hundreds of hotel development budgets and no two are alike. Evaluating the completeness of a budget is often challenging, as different line items are used and some components are unintentionally omitted. We can be presented with budgets showing extraordinary line-item detail, with every material component itemized.

Others are too cursory and lump together major items without enough detail. We are often asked for input on hotel development budgets and find that lacking a common language for discussing relevant cost items is a challenge for many industry participants. From the annual preparation of the Hotel Development Cost Survey we have developed the following summary format for development budgets which forms the basis for our cost categories. We find these categories are meaningful for hotel professionals when undertaking analysis relating to hotel feasibility. While our structure is not an accounting practice, it does provide a basis to analyze proposed projects.

The following chart shows our five categories and the typical items that each include.

EXHIBIT 2: HVS HOTEL DEVELOPMENT COST CATEGORIES

HVS Hotel Development Cost Survey Categories
Land
Hard Construction and Site Improvements
Building costs/general contractor's bid
Contractor overhead
Site improvements
Landscaping costs
Parking/parking garage
Subcontractor's bids (plumbing, electrical, etc), finishes
Architectural/design fees
Building permits
Engineering costs
Building and monument signage
Construction contigency
Soft Costs
Land entitlement costs
Land closing costs
Financing costs including construction period interest, interest reserves, loan closing costs
Holding costs per and during construction (taxes, insurance, etc.)
Soft cost contingency
Franchise application fee
Interior design fee
Survey
Professional fees including accounting, consulting, legal, etc.
Furniture, Fixtures, and Equipment
Guestroom/guest bathroom furniture and fixtures
Public space and meeting room furniture and fixtures
Technology and telecommunication equipment
Kitchen and Laundry equipment
Softgoods including carpeting, drapes, room accessories
Pre-opening and Working Capital
Supply inventories - linen, operating supplies, initial purchases
Technical services fees
Pre-opening recruiting, staffing, and training
Operating reserves

Source: HVS

The categories are not meant to be all encompassing but do reflect the typical items in a development budget. Land is often the most important component as its cost can make or break the profitability of a project. Oftentimes, the dollar amount of the land in a development budget is based on a contribution by an equity participant or an allocation based on the overall cost. When evaluating the feasibility of a project, the land cost is most relevant when it is an actual purchase price or based on the market value of the site "as is." In some budgets, we may see a development fee or developer overhead. If the amount represents the overhead and salaries and wages earned by the development team during a project, we will include this in soft costs. If the fee represents the profit on the project, it will be excluded.

Financing and operating reserves are important items to include in development budgets. These costs are often missing in budgets that we review. Sometimes these costs or other pre-opening and marketing costs are omitted from the budget and amortized in the profit and loss statements. It is critical to acknowledge their overall costs as part of the potential feasibility of a new hotel.

In construction accounting, development budgets are generally presented in far greater detail than for general investment analysis. For the purposes of considering the overall feasibility of a proposed hotel, we find our Hotel Development Survey categories cover the major components of hotel construction costs.

PER-ROOM HOTEL DEVELOPMENT COSTS

The nadir of hotel development costs in the most recent cycle was 2010; costs in most categories have increased since then. The averages and medians reflect a broad range of development projects across the US, including projects in areas with low barriers to entry and in high-priced urban and resort destinations.

EXHIBIT 3: 2013/14 HOTEL DEVELOPMENT COST PER ROOM AMOUNTS

	Land	Building and Site Improvements	Soft Costs	FF&E	Pre-Opening and Working Capital	Total
Budget/Economy Hotels						
Average	$12,300	$58,700	$5,800	$8,300	$3,200	$77,400
Median	$11,800	$53,300	$2,900	$8,300	$3,000	$71,200
Allocation	14%	66%	10%	11%	3%	
Midscale Hotels w/o F&B						
Average	$15,400	$77,200	$11,700	$10,300	$4,200	$109,100
Median	$14,100	$68,300	$8,500	$10,000	$4,000	$93,100
Allocation	12%	68%	9%	11%	2%	
Extended-Stay Hotels						
Average	$12,800	$83,800	$11,600	$13,400	$3,700	$141,000
Median	$11,400	$75,000	$10,200	$13,800	$3,500	$121,900
Allocation	10%	68%	9%	13%	1%	
Midscale Hotels w/ F&B						
Average	$14,600	$83,100	$13,600	$13,900	$3,900	$129,400
Median	$11,000	$68,500	$10,700	$13,000	$3,700	$110,900
Allocation	16%	63%	11%	11%	1%	
Full-Service Hotels						
Average	$36,300	$154,900	$17,200	$25,400	$17,200	$267,900
Median	$35,000	$140,600	$14,400	$24,700	$16,000	$214,800
Allocation	14%	65%	10%	11%	4%	
Luxury Hotels and Resorts						
Average	$93,600	$373,900	$81,900	$56,800	$20,800	$641,000
Median	$91,300	$324,200	$90,400	$60,700	$18,700	$576,500
Allocation	18%	58%	14%	10%	4%	

Source: HVS

EXHIBIT 4: HOTEL DEVELOPMENT COST SURVEY PER-ROOM RANGE OF COSTS FOR 2013/14

	Land	Building and Site Improvements	Soft Costs	FF&E	Pre-Opening and Working Capital	Total
2013						
Budget/Economy Hotels	$6,500 - $28,500	$43,600 - $82,200	$1,200 - $13,700	$5,100 - $17,400	$1,500 - $7,100	$53,000 - $158,700
Midscale Hotels w/o F&B	$7,400 - $76,800	$51,700 - $123,600	$2,200 - $61,200	$6,400 - $26,900	$2,800 - $25,700	$67,100 - $208,500
Extended Stay Hotels	$10,000 - $43,500	$68,500 - $165,000	$2,600 - $88,400	$8,100 - $25,800	$2,900 - $26,100	$87,700 - $231,600
Midscale Hotels w/ F&B	$9,600 - $55,600	$80,900 - $173,700	$3,700 - $50,500	$10,400 - $38,100	$3,400 - $18,900	$104,100 - $308,800
Full-Service Hotels	$21,100 - $101,900	$132,700 - $379,100	$4,600 - $94,600	$21,500 - $55,100	$13,700 - $85,500	$180,300 - $615,300
Luxury Hotels and Resorts	$43,600 - $224,500	$239,100 - $518,400	$23,600 - $117,000	$36,200 - $123,100	$18,700 - $82,200	$428,000 - $942,700

Source: HVS

It is important in this analysis to reiterate the lack of a uniform system of hotel development budget allocation. Hotel development costs are accounted for in numerous and varied 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, equipment installation, and construction finish work can overlap. Accounting for these items is not always the same from one project to another.

Additionally, we recommend that users of the HVS Hotel 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 included 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. Hotels developed in high cost markets such as New York only account for a small percentage of the projects but typically have per room component costs that set the upper end of the range. 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, mixed-use, shared ownership, gaming, and leisure industries. Established in 1980, the company performs 4500+ assignments each year for hotel and real estate owners, operators, and developers worldwide. HVS principals are regarded as the leading experts in their respective regions of the globe. Through a network of more than 30 offices and 450 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry.
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HVS CONSULTING & VALUATION in San Francisco, established in 1985 by Suzanne R. Mellen, performs numerous and varied consulting and valuation assignments. Our feasibility studies and appraisals have won wide acceptance among a broad base of developers, investors and the lending community.

About the Author

Elaine Sahlins is a Senior Vice President with HVS San Francisco, She joined the firm in 1997, and authors the annual Hotel Development Cost Survey (since 1998). She specializes in resort feasibility studies, appraisal of complex leases, partial interest appraisals, management company valuations, and hotel market analysis. Elaine is a state-certified general appraiser in California, and a current candidate for MAI designation from the Appraisal Institute (expected 2014). Prior to joining HVS, she analyzed hotel investments for VMS Realty in Chicago, and was a review appraiser with Bank of America in San Francisco. Elaine holds an undergraduate degree from Barnard College, Columbia University in New York City and an MPS degree in Hotel Administration from Cornell University.
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