

2004



Hotel Development Cost Survey

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HVS International has tracked hotel construction costs throughout the United States since 1976. In 2001, the survey introduced data for a larger range of hotel products, setting new baseline ranges 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 2004 hotel development survey reports updated per-room development costs for 2003.

Each year HVS International 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. These development cost ranges are then adjusted each year based on data reflecting the trend in each component cost category.

According to the census bureau, the volume of lodging construction in the U.S. remained relatively stable—\$10,823 million in 2002 to \$10,715 million in 2003—while total construction surged 5% from \$650,495 million to \$682,969 million, led by the increase in housing starts, which increased 10.34% from \$427,548 million in 2002 to \$471,789 million in 2003. As a whole, 2003 proved to be a volatile year for construction costs: lumber prices surged as did prices for steel, light structural components, plywood, and rebar. Increases in fuel costs also contributed to increased costs. Labor costs increased, partially due to upward pressure from workers' compensation costs. The strength of new home starts put competitive pressures on certain construction materials, particularly wood products which began an upward trend in 2003. China's demand for scrap also propelled pricing of other construction materials, particularly steel and rebar.

According to the Bureau of Labor Statistics, costs for many construction materials showed notable increases in 2003. The following table illustrates a sample of these trends.



Construction Cost Changes 2000 - 2003

	Materials and Components for Construction	Lumber	Iron and Steel	Steel mill products
2000	1.2 %	(5.0) %	2.3 %	2.9 %
2001	(0.1)	(4.0)	(5.9)	(6.5)
2002	0.5	(0.6)	4.0	3.5
2003	1.5	2.2	6.5	4.5

Source: Bureau of Labor Statistics

While many of these costs had declined in recent years, construction expenditures, across the board, were all higher in 2003. Iron and steel increased at a compound rate of 11.55%, followed by steel mill products at an 8.2% compound rate over the two-year period. Clearly these costs have direct implications for higher development costs, particularly for urban and larger destination projects.

Another influence on hotel development costs was the increasing availability and cost of financing. During 2003, lenders warmed significantly to hotel refinancing, although money for new construction was relatively scarce. The following chart represents the upward trends in hotel financing transactions as reported by respondents to the Mortgage Bankers Association survey.

Hotel/Motel Loan Origination

	2003			2002		
	Volume	Number of Loans	Average Loan Size	Volume	Number of Loans	Average Loan Size
1st Quarter	\$1,021	24	\$43	\$82	10	\$8
2nd Quarter	508	27	19	375	19	20
3rd Quarter	443	24	18	380	22	17
4th Quarter	858	47	18	425	33	13
	\$2,830	122	\$23	\$1,262	84	\$15

Source: Mortgage Bankers Association of America

Although interest rates remained low, lenders' appetite for providing construction financing was still limited as compared to the end of the last decade. Financing for existing product has been more readily available than for new construction. Many lenders report that traditional first mortgage loan-to-value ratios for existing acquisitions were trending upwards, some as high as 75% toward the end of 2003, while construction loans are still moderated at 50% to 60% of the lower of value or construction cost. Although interest rates remain at



their relative nadir for hotel lending, the amount of equity required to complete projects may be prohibitive for some developments.

Despite the challenges, new hotel development continued to be proposed for many urban, suburban, and resort markets in the U.S. In the luxury and upper-upscale market, hotel projects are more likely to be developed when planned in conjunction with condominium, fractional, time-share, or condo-hotel components. These mixed-use assets allow developers to subsidize the hotel costs with the more lucrative ownership units. Purchasers of the ownership units, be they condominium, fractional, time-share, or condo-hotel, avail themselves of the hotel services and amenities, elevating the traditional second-home purchase into a vacation experience.

HVS International's 2003 Hotel Development cost survey incorporates new trends in hotel development that directly affected the survey results. In addition to the impact of material price increases, the geographic distribution of hotel development challenged some of the ranges of overall development costs per room in the different categories of our analysis. In 2003, New York City's strong hotel market dynamics attracted hotel developers. In particular, per-room costs ranges in the budget/economy and mid-scale with food and beverage categories are driven by development budgets for hotels in Manhattan. While average rates for these Manhattan hotels are likely to push the envelope for the particular brands, so are the development costs. Many brands continue to seek representation in New York, currently one of the strongest hotel markets in the country, and other urban locales.

The decline in the low end of the range of per-room costs for the luxury segment in the HVS survey is based on development budgets for five-star hotels that are constructed as part of mixed-use projects. By allocating the infrastructure and land costs to complementary uses such as residential and retail, the hotel component can be more feasibly developed. Outright sale of residential or hotel condominium units and initial lease-up of retail and restaurant space can help leverage the construction costs of the project so the hotel's cost basis is significantly lower than a stand-alone lodging development.

Midscale brands, both with and without food and beverage, continue to actively seek distribution for their products. Many of these brands are being planned in different types of markets than in prior development cycles. Some franchised products are being developed in secondary and tertiary markets with smaller prototypes, while other midscale brands are being approved for development in dense urban markets. The higher development costs are sometimes rendered more feasible by larger projects or mixed-use projects, which may include two or more differently branded hotels in the same structure.



The performance of many primary and secondary hotel markets showed promising signs of recovery beginning at the end of 2003, interpreted by investors as a time to add capital to the industry, through acquisitions, sales, and renovations. As occupancies improved, investors continued to pursue projects that had been shelved during poor post-September 11 market conditions. For some projects, raw material and insurance costs, among others, had notably increased since the original project budgets, forcing costs upwards. Many developers expect that average rate rebounds will coincide with revised construction schedules, supporting project feasibility.

In the hotel development cycle of the 1990s when recession and war dampened hotel performance, the mantra of "Stay alive 'til '95" did indeed materialize as RevPAR, largely driven by average rate gains, propelled a strong hotel market through 2000. The expectation that 2003 was the bottom of this cycle seems to be supported by subsequent events in 2004. While hotel development is expected to continue to be more expensive, the improving hotel market will undoubtedly spark additional hotel development.

The following tables set forth the overall results of the 2004 Hotel Development Cost Survey. Due to the wide variety of development projects and their diverse geographic locations, ranges of development costs per room for all of the other property-type categories overlap. Additional differences in site characteristics, density, height, construction materials, building and zoning codes, local labor markets, and other construction costs, account for the wide range of per-room costs in each category. As an example, extended-stay and limited-service hotels may be more expensive (on a per-room basis) to develop in downtown urban areas than full-service hotels in suburban or tertiary cities.

Even with all the different circumstances that affect hotel development across the different segments, it is interesting to note that the allocation of costs among the five different components tracked by HVS International result in consistent contribution ratios to total development cost. With the exception of the luxury and resort development category, all of the cost components show consistent trends in their distributions of costs. In the luxury and resort category, the different land and building and site improvements costs reflect the expense of procuring typically larger sites with high barriers to entry in urban and resort destinations.

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, fixture, 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 International Development Cost Survey should 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 categories 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 table below are from per-room budgets from hotel developments and are not a sum of the individual components.

All material used by HVS International for the development cost survey is provided on a confidential basis and is believed to be reliable. Data from individual sources is not disclosed. ■

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 International in 1987 as a Director in the San Francisco office. Elaine assumed responsibility for the Hotel Development Cost Survey in 1998.

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2004 Hotel Development Cost Survey Per-Room Averages for 2003

	Land	Building and Site Improvements	Soft Costs	FF&E	Pre-Opening and Working Capital	Total
Budget/Economy Hotels						
Average	\$14,200	\$40,800	\$4,200	\$8,300	\$3,000	\$61,800
Median	13,600	37,100	2,200	8,300	2,800	50,000
Allocation	9%	66%	6%	13%	4%	
Midscale Hotels w/o F&B						
Average	\$95,500	\$61,600	\$14,000	\$9,900	\$3,000	\$97,100
Median	14,300	56,400	8,700	9,200	2,700	81,600
Allocation	14%	66%	12%	11%	4%	
Extended-Stay Hotels						
Average	\$15,500	\$74,900	\$12,400	\$13,200	\$3,200	\$124,400
Median	13,700	65,400	10,600	13,500	2,300	103,700
Allocation	13%	63%	9%	12%	2%	
Midscale Hotels w/ F&B						
Average	\$16,700	\$69,300	\$13,200	\$12,000	\$3,600	\$108,700
Median	11,800	57,500	10,900	11,400	2,800	92,300
Allocation	11%	64%	12%	11%	3%	
Full-Service Hotels						
Average	\$19,600	\$106,600	\$24,200	\$22,500	\$5,500	\$188,100
Median	15,100	100,400	18,600	18,600	5,800	159,000
Allocation	10%	61%	14%	13%	2%	
Luxury Hotels and Resorts						
Average	\$100,500	\$303,600	\$96,000	\$77,500	\$20,400	\$598,300
Median	94,300	276,300	91,400	67,500	19,400	571,700
Allocation	17%	53%	15%	13%	4%	

Source: HVS International



2004 Hotel Development Cost Survey Per-Room Range of Costs for 2003

	Land	Building and Site Improvements	Soft Costs	FF&E	Pre-Opening and Working Capital	Total	Range of % Change
2003							
Budget/Economy Hotels	\$4,100 - 25,400	\$20,800 - \$65,400	\$600 - \$6,500	\$3,100 - \$15,000	\$1,200 - \$6,400	\$32,400 - \$108,000	(1.5) % - 36.4 %
Midscale Hotels w/o F&B	4,200 - 33,100	30,200 - 108,200	2,800 - 36,200	5,500 - 16,500	1,200 - 12,500	53,000 - 188,200	8.2 - 0.0
Extended Stay Hotels	5,600 - 42,800	45,500 - 130,900	3,800 - 41,700	7,800 - 20,000	1,300 - 8,500	74,400 - 193,000	10.4 - 2.9
Midscale Hotels w/ F&B	3,500 - 65,200	36,200 - 154,100	3,000 - 41,600	6,200 - 23,000	1,300 - 7,800	61,100 - 227,900	0.0 - 11.8
Full Service Hotels	5,800 - 89,500	54,300 - 222,500	3,500 - 72,000	6,800 - 50,100	1,600 - 23,100	78,200 - 323,500	46.4 - 0.0
Luxury Hotels and Resorts	36,000 - 220,800	150,200 - 1,069,600	33,000 - 214,100	47,100 - 116,600	15,600 - 45,100	333,500 - 1,365,500	(5.6) - 69.8
2002							
Budget/Economy Hotels	\$4,500 - \$14,100	\$20,800 - \$51,800	\$400 - \$4,100	\$2,900 - \$14,700	\$1,100 - \$5,300	\$32,900 - \$79,200	(2.1) % - 2.9 %
Midscale Hotels w/o F&B	4,200 - 32,100	30,100 - 105,000	2,000 - 35,200	5,300 - 16,300	1,200 - 12,300	49,000 - 188,200	(2.6) - 2.2
Extended Stay Hotels	5,700 - 32,100	42,700 - 99,400	3,800 - 21,300	7,600 - 19,400	1,300 - 7,100	67,400 - 187,600	(3.2) - 2.1
Midscale Hotels w/ F&B	3,400 - 50,700	36,200 - 161,800	3,000 - 40,500	6,100 - 21,800	1,300 - 7,700	61,100 - 203,900	(3.3) - 0.8
Full Service Hotels	5,400 - 57,300	52,500 - 235,900	3,400 - 70,700	6,700 - 48,400	1,500 - 22,900	53,400 - 323,500	(3.4) - 1.2
Luxury Hotels and Resorts	36,000 - 128,300	150,200 - 322,900	32,900 - 207,700	44,300 - 98,300	15,100 - 28,500	353,300 - 804,000	(3.0) - 1.5
2001							
Budget/Economy Hotels	\$4,400 - \$9,500	\$13,500 - \$44,600	\$300 - \$3,400	\$2,900 - \$12,700	\$800 - \$5,400	\$29,800 - \$65,500	(2.2) % - 3.0 %
Midscale Hotels w/o F&B	5,500 - 27,500	28,500 - 84,000	1,400 - 18,000	4,500 - 19,000	1,000 - 12,600	43,500 - 136,600	(7.4) - 2.7
Extended Stay Hotels	5,500 - 38,600	31,500 - 120,500	2,000 - 18,500	3,200 - 20,400	1,400 - 8,600	46,500 - 185,300	(9.8) - 2.4
Midscale Hotels w/ F&B	6,000 - 31,500	28,200 - 157,200	3,200 - 40,900	6,700 - 21,100	1,600 - 9,200	50,500 - 205,500	(10.0) - 2.2
Full Service Hotels	8,000 - 79,500	53,000 - 227,800	3,600 - 67,800	11,500 - 41,000	2,300 - 23,200	67,200 - 336,200	(11.2) - 1.5
Luxury Hotels and Resorts	18,500 - 115,200	145,000 - 290,500	25,000 - 140,100	36,000 - 106,700	5,500 - 28,500	254,300 - 584,000	(16.2) - 3.4