# Hotel Development Cost Survey 2009

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**November 17, 2009**

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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. This year, the time period for the survey has been expanded to include data from the first half of 2009; as such, the 2009 hotel development survey reports updated per-room development costs for 2008/09.

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 are adjusted by changes in construction cost components derived from published sources and information from architects, contractors, developers, lenders and other professionals involved with hotel development projects.

The survey is not meant to be a comparative tool to calculate changes from year to year but represents the true costs of building hotels across the United States. As with previous years' data, the data represent a wide variety 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.

**A Period of Changes**

The last eighteen months can be regarded as a period of changes and challenges. For most markets, the first three quarters of 2008 reflected a continuation of the strong performance trends from the prior three years. Occupancy had been stabilizing and many operators had been able to increase rates over those of 2007. By mid-year 2008, many business and consumers were feeling the impact of the contracting economy and corporations and individuals tightened their travel spending. With the darkening cloud of the credit crisis and the implosion of Bear Stearns and Lehman Brothers, travel in the U.S. severely contracted—almost overnight. The RevPAR declines beginning in the second half of 2008 and continuing through 2009 have challenged the whole outlook of the hotel industry.

The impact of the industry's operating performance on hotel development has been notable. Over the course of 2009, the declining operating performance of hotels and the continued constriction of available debt have resulted in the stoppage, postponement, and cancellation of numerous projects across all hotel product types. While a significant number of planned hotel projects have been put on hold or cancelled, a large amount of new supply is still moving through the pipeline. Because of the timing of development projects, the impact on supply growth will not be manifested in some markets until 2010/2011. As seen in the following chart, the mid-year supply growth for 2009 is still within the range of new supply growth from prior years.

**Table 1 – Hotel Room Supply Growth – Dec. 2006 through Sept. 2009**

| | Dec-06 Existing Supply | % of Total | Dec-07 Existing Supply | % of Total | Dec-08 Existing Supply | % of Total | Sep-09 Existing Supply | % of Total | Total Change Dec 2006 to Sept 2009 |
|---|---|---|---|---|---|---|---|---|---|
| Luxury | 80,062 | 1.8 % | 81,463 | 1.8 % | 96,635 | 2.1 % | 104,735 | 2.2 % | 30.82 % |
| Upper Upscale | 539,457 | 12.1 | 546,288 | 12.0 | 571,680 | 12.2 | 593,695 | 12.4 | 10.05 |
| Upscale | 406,932 | 9.1 | 429,458 | 9.4 | 460,147 | 9.8 | 498,752 | 10.4 | 22.56 |
| Midscale with F&B | 534,063 | 12.0 | 539,628 | 11.9 | 511,001 | 10.9 | 510,475 | 10.6 | (4.42) |
| Midscale w/out F&B | 694,954 | 15.6 | 735,402 | 16.2 | 776,247 | 16.5 | 817,053 | 17.0 | 17.57 |
| Economy | 731,812 | 16.4 | 740,917 | 16.3 | 758,915 | 16.2 | 764,158 | 15.9 | 4.42 |
| Independents | 1,466,755 | 32.9 | 1,477,148 | 32.5 | 1,518,965 | 32.4 | 1,507,836 | 31.4 | 2.80 |
| Totals | 4,454,035 | 100.0 | 4,550,304 | 100.0 | 4,693,590 | 100.0 | 4,796,704 | 100.0 | 7.69 % |
| Percent Change | | | 2.2 | | 3.1 % | | 2.2 % | | |

Source: Smith Travel Research

While new hotels continue to open, the composition of the new supply has changed as compared to 2006. That year reflects the point in the development cycle when readily available financing and a strong economy propelled a larger increase in the development of higher-rated product types than in the prior year. With the expectation of continued rising average rates and buyers for the for-sale real estate that supported the luxury projects, these projects were expected to provide strong investment returns to developers.

Another interesting shift is the actual decline in the number of midscale hotel rooms with food and beverage. Many of these hotels are older full-service hotels in secondary or tertiary markets with now obsolete designs and/or locations. Traditionally, as these properties decline, their franchise affiliations also often downgraded until the cost of maintaining the property and a brand results in a value that is less than the underlying land. One of the major cost estimating sources, Marshall & Swift, opines on the useful life of a hotel as being 40 to 60 years. In many smaller markets across the U.S., one can readily identify these hotels from the 1950s through the 1970s with their sprawling low-rise configurations or exterior-corridor design. Our expectation is that when the economy recovers, more and more of these hotels will be repositioned at lower market levels or demolished for higher and better uses.

As shown in the following chart, future hotel development is expected to continue to moderate, boding well for long-term performance recovery.

**Table 2 – Supply Pipeline**

| | December 2007 in Construction | Sept. 2009 in Construction | % Change | Active Pipeline December 2007 | Active Pipeline Sept 2009 | % Change |
|---|---|---|---|---|---|---|
| Luxury | 7,495 | 4,776 | (36.3) % | 13,353 | 8,971 | (32.8) % |
| Upper Upscale | 18,986 | 12,555 | (33.9) | 42,093 | 25,932 | (38.4) |
| Upscale | 52,340 | 31,116 | (40.6) | 151,779 | 109,081 | (28.1) |
| Midscale with F&B | 8,503 | 7,879 | (7.3) | 30,561 | 25,905 | (15.2) |
| Midscale w/out F&B | 59,172 | 40,206 | (32.1) | 175,695 | 131,485 | (25.2) |
| Economy | 10,442 | 5,240 | (49.8) | 22,892 | 13,601 | (40.6) |
| Independents | 28,181 | 19,942 | (29.2) | 176,519 | 135,924 | (23.0) |
| Totals | 185,119 | 121,714 | (34.3) % | 612,892 | 450,899 | (26.4) % |

Source: Smith Travel Research

The total pipeline for new hotel rooms (which includes rooms under construction) is down over 26% since the end of 2007. The overall pace of development in the past eighteen months largely relied on development projects conceived and financed in prior years.

**Development Cost Changes**

With the decline in the development pipeline, land is often the first component to reflect value shifts and can demonstrate the greatest change in value. As with all real estate, land owners who are not motivated to sell due to financial circumstances often hold on to their property until offers are more in line with their expectations. In master-planned developments, the hotel may be a marketing amenity for the other uses, motivating the master developer to sell the hotel site at a discount. With the challenges to financing new hotel development in the past eighteen months, fewer buyers have sought sites. Land values have notably declined and many properties have been withdrawn from the market. As a result, very few transactions of land for new hotel development have occurred. Based on discussions with owners, developers, and brokers, hotel land and construction costs are the most impacted of our cost categories.

According to a number of construction surveys and indexes, including data from Engineering News Record and the US Bureau of Economic Analysis, overall construction material costs were down 1% to 5% in 2008 and down another 1% to 3% in the first half of 2009, affected by a decreasing demand for construction and increasing competition among contractors. Initially in 2008, while some component prices were decreasing, higher labor costs from contracts negotiated in prior years resulted in overall higher construction budgets. This trend has now reversed and the construction unemployment rate as of September 2009 is over 17%. Material costs continue to decline. During 2008, for example, lumber prices dropped 8% but for the twelve months ending in July 2009, prices further declined 10%. The price of steel was up 12.5% in 2008 but for the twelve months ending in July 2009 was down 15.3%. Copper and aluminum were both lower in 2008 (-24.2% and -2.8% respectively). In the beginning of 2009, prices for both metals continued to decline however. Although prices for these metals began to increase in the third quarter of 2009 with some increases in demand, they are still off the peak costs. Financing costs for those projects under development were still subject to favorable terms initiated in a more robust environment.

The cost of green construction continues to be debated. Advocates who emphasize 100% green construction projects as compared with select enhancements to a development, maintain that if a project is planned with environmental concerns from conception, the cost difference to a convention development is minimal. RSMeans cites studies showing a 2% to 5% cost difference, attributing much of the higher costs to increased architectural and engineering design time necessary to integrate sustainable building practices into the projects. Another additional cost is for commissioning. The federal government defines commissioning as a systematic and documented process of ensuring that the owner's operational needs are met, building systems perform efficiently, and building operators are properly trained. The commissioning team is now becoming an integral part of the development team, particularly on green developments. The savings from buildings systems properly designed, installed, and operationally integrated are expected to exceed any initial costs during the development.

Fewer development projects mean fewer construction services. As with contractors, more construction providers are chasing the same clients. Soft costs have been less affected than other categories as public agency fees have not declined.

As revenues have decreased since the beginning of 2008, hotel operators have responded with significant operating cost reductions in labor and other expenses, including inventories and supplies. Hotels opening in this environment are often staffed more judiciously than in previous years and pre-opening costs are reportedly lower than in prior years. Declining costs are expected to continue through at least the end of the year, though the tough financing market is anticipated to continue to challenge the pipeline through at least the end of 2010. Although development is more affordable, fewer projects are receiving commitments and interest in new construction has declined. The hope is that lower construction costs can help stimulate new hotel development as the industry recovers.

Lower costs in the 2008/09 development cost survey have the greatest impact on the land and building improvements. Other categories, as shown in the following table, are not as volatile.

**Table 3 – 2008/09 Hotel Development Cost Survey per-Room Averages (Based on 2008/09 Amounts)**

| | Land | Building and Site Improvements | Soft Costs | FF&E | Pre-Opening and Working Capital | Total |
|---|---|---|---|---|---|---|
| **Budget/Economy Hotels** | | | | | | |
| Average from Budgets | $13,800 | $48,800 | $4,500 | $8,500 | $3,000 | $63,900 |
| Median | $13,200 | $44,400 | $2,300 | $8,500 | $2,900 | $51,700 |
| Allocation | 14% | 55% | 8% | 8% | 4% | |
| **Midscale Hotels w/o F&B** | | | | | | |
| Average from Budgets | $27,500 | $68,700 | $11,400 | $10,000 | $4,100 | $96,100 |
| Median | $14,400 | $60,700 | $8,300 | $9,700 | $2,800 | $80,500 |
| Allocation | 16% | 65% | 10% | 10% | 4% | |
| **Extended-Stay Hotels** | | | | | | |
| Average from Budgets | $14,400 | $76,000 | $11,700 | $13,300 | $3,300 | $129,000 |
| Median | $12,800 | $66,600 | $10,200 | $13,700 | $2,400 | $103,400 |
| Allocation | 12% | 68% | 9% | 12% | 2% | |
| **Midscale Hotels w/ F&B** | | | | | | |
| Average from Budgets | $16,300 | $73,800 | $13,600 | $12,600 | $3,800 | $115,000 |
| Median | $12,000 | $60,900 | $10,700 | $11,900 | $3,000 | $98,600 |
| Allocation | 13% | 66% | 12% | 12% | 3% | |
| **Full-Service Hotels** | | | | | | |
| Average from Budgets | $18,700 | $120,500 | $22,700 | $23,200 | $6,900 | $206,000 |
| Median | $14,700 | $109,400 | $14,300 | $19,000 | $5,700 | $154,700 |
| Allocation | 12% | 64% | 12% | 12% | 4% | |
| **Luxury Hotels and Resorts** | | | | | | |
| Average from Budgets | $96,300 | $338,900 | $136,500 | $56,800 | $20,800 | $592,600 |
| Median | $98,400 | $293,900 | $90,400 | $60,700 | $18,700 | $532,900 |
| Allocation | 17% | 65% | 11% | 8% | 5% | |

Source: HVS

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## Table 4 – Hotel Development Cost Survey per-Room Range of Costs for 2006 – 2008/09

| | Land | Building and Site Improvements | Soft Costs | FF&E | Pre-Opening and Working Capital | Total |
|---|---|---|---|---|---|---|
| **2008/09** | | | | | | |
| **Budget/Economy Hotels** | $4,300 - $30,400 | $30,100 - $94,500 | $600 - $13,000 | $4,600 - $17,100 | $1,400 - $7,100 | $39,300 - $141,000 |
| **Midscale Hotels w/o F&B** | 4,200 - 86,000 | 45,000 - 168,800 | 2,100 - 61,200 | 5,700 - 26,400 | 900 - 25,700 | 59,600 - 381,800 |
| **Extended Stay Hotels** | 2,600 - 46,400 | 51,200 - 158,900 | 2,300 - 84,200 | 3,600 - 24,500 | 700 - 25,300 | 69,800 - 265,000 |
| **Midscale Hotels w/ F&B** | 3,900 - 64,100 | 45,300 - 145,900 | 3,400 - 63,100 | 6,900 - 37,400 | 300 - 18,900 | 73,200 - 296,800 |
| **Full-Service Hotels** | 3,900 - 111,200 | 60,800 - 350,300 | 2,300 - 118,300 | 8,600 - 54,600 | 1,900 - 85,500 | 96,100 - 585,600 |
| **Luxury Hotels and Resorts** | 13,500 - 247,500 | 180,200 - 1,383,900 | 24,800 - 229,400 | 34,400 - 121,900 | 10,400 - 80,600 | 411,300 - 1,466,900 |
| **2007** | | | | | | |
| **Budget/Economy Hotels** | 4800 - $32,000 | $30,100 - $95,100 | $600 - $14,200 | $4,900 - $18,000 | $1,400 - $7,500 | $43,700 - $156,700 |
| **Midscale Hotels w/o F&B** | $4,600 - 93,100 | 52,000 - 187,500 | 2,300 - 64,700 | 6,000 - 27,800 | 1,000 - 26,800 | 68,000 - 433,900 |
| **Extended Stay Hotels** | 2,900 - 51,500 | 58,300 - 186,900 | 2,500 - 93,500 | 3,800 - 26,100 | 700 - 26,800 | 78,600 - 301,100 |
| **Midscale Hotels w/ F&B** | 4,200 - 72,800 | 52,200 - 162,000 | 3,700 - 65,600 | 7,500 - 39,400 | 300 - 19,900 | 81,600 - 337,300 |
| **Full-Service Hotels** | 4,300 - 126,400 | 53,100 - 412,100 | 2,600 - 131,400 | 9,100 - 57,500 | 2,000 - 90,000 | 109,700 - 665,400 |
| **Luxury Hotels and Resorts** | 15,300 - 271,100 | 206,000 - 1,537,700 | 28,400 - 254,900 | 37,000 - 128,300 | 11,300 - 86,600 | 462,700 - 1,725,800 |
| **2006** | | | | | | |
| **Budget/Economy Hotels** | $4,900 - $32,000 | $28,700 - $89,700 | $600 - $13,900 | $4,800 - $17,900 | $1,400 - $7,300 | $42,800 - $149,200 |
| **Midscale Hotels w/o F&B** | 4,500 - 93,100 | 49,500 - 176,900 | 2,300 - 63,400 | 5,800 - 26,500 | 1,000 - 26,000 | 66,700 - 413,200 |
| **Extended Stay Hotels** | 2,900 - 51,500 | 55,500 - 176,300 | 2,400 - 91,700 | 3,700 - 24,900 | 700 - 26,000 | 74,900 - 286,800 |
| **Midscale Hotels w/ F&B** | 4,200 - 72,800 | 49,700 - 154,300 | 3,600 - 64,300 | 7,300 - 37,500 | 300 - 19,300 | 77,700 - 321,200 |
| **Full-Service Hotels** | 4,400 - 123,900 | 50,600 - 392,500 | 2,500 - 128,800 | 8,800 - 55,300 | 1,900 - 87,400 | 104,500 - 633,700 |
| **Luxury Hotels and Resorts** | 15,100 - 268,400 | 196,200 - 1,478,600 | 27,600 - 249,900 | 35,900 - 123,400 | 11,000 - 84,100 | 440,700 - 1,659,400 |

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 material 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 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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