

2006



Hotel Development Cost Survey

Elaine Sahlins, Senior Vice President
HVS International San Francisco

HVS INTERNATIONAL SAN FRANCISCO

116 New Montgomery Street
Suite 620
San Francisco, CA 94105
(415) 896.0868
(415) 896.0516 (fax)

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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 2006 hotel development survey reports updated per-room development costs for 2005.

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.

It is no surprise that hotel development costs are at an all-time high. Prices for land, building materials, freight, and labor have altered the concept of hotel development for the foreseeable future. As has happened historically during numerous hotel cycles, feasible development of stand-alone upscale or luxury full-service hotels remains challenging, yet the plentiful availability of funds and low interest rates continue to motivate developers. Project completion, however, remains elusive for many full-service and luxury hotels. Innovation and lifestyle changes have spurred the adoption of mixed-use development concepts such as lifestyle hotels, condo hotels, hotels with residential components, and other forms of mixed-use projects by developers throughout the U.S. and internationally. The integration of hotel, residential, and other uses often improves the feasibility of an entire project.

Numerous sources report that the pipeline of all new hotel construction is at an all-time low. Smith Travel Research reports that "from January to December 2005, the number of new hotel rooms in the U.S. increased just 0.4%—that's not much, especially when compared with the historical average of 2.2% per year." Increased construction costs are reported by many developers as hampering new hotel development. In 2006, the pipeline is starting to increase as the prices paid for existing hotels is trending toward the cost of turn-key development.

Land costs continued to increase in 2005 from the prior year. Condominium developers were readily acquiring land in urban and suburban markets. When hotel developers competed for sites designated for condominium and mixed-use projects, the economics of the projects with residential components often allowed those developers to win the deals. Land prices for some desirable sites began to exceed the value of improved property, spurring developers to tear down existing improvements as part of the development process.

But cost is not the only influence on new hotel development. The changing tastes and demographics of hotel users are also forcing a shift in development trends. We are in the middle of a small revolution driven by demand for a new type of hotel environment. Hyatt Place, Indigo, Element, Aloft, and Cambria Suites are all examples of hotel companies' strategy to increase distribution and capture the next generation of guests. Often referred to as "lifestyle hotels," the new products are designed to attract new demand with cutting-edge design and technology features.



Construction cost increases, however, have been driven less by design and technology changes than by competition for the resources. Consistent with the past few years, the surge of construction in China, and the increase in fuel costs from 2004 to 2005 have driven up construction material costs for products such as PVC, copper pipe, gypsum, and wire and cable. China is also a major exporter of steel used for all construction. Steel prices increased most dramatically by 30% in 2004, moderating to a 13% increase in 2005. Shipping costs, largely driven by the cost of fuel, also inflated many development budgets. With many operating inventory items and casegoods being produced in China, shipping costs have influenced other components of hotel development budgets.

Within the U.S., hotel development costs are particularly affected by the competition for labor and materials with other types of construction. Consider the following data for construction starts for 2005 compiled by the Bureau of Economic Analysis.

Table 1 – Construction Starts in 2005

| Type of Construction | Total \$ (millions) | Percentage of Total |
|-----------------------------------------|---------------------|---------------------|
| Total Private Construction | \$10,775,579 | |
| Residential (incl. Improvements) | 7,695,692 | 71.4 % |
| New single-family | 5,185,934 | |
| New multi-family | 579,077 | |
| Nonresidential | 3,079,891 | 28.6 % |
| Lodging | 153,704 | 1.4 % |
| Office | 442,712 | 4.1 % |

Source: Bureau of Economic Analysis

As seen in the preceding table, residential development—particularly single-family housing—dominated the construction industry in 2005. The value of all non-residential construction, which includes private and public projects, is less than that of single-family housing. Hotels represent only 1.4% of new construction expenditures in 2005. If the housing market continues to soften as the recent trends are indicating, construction and labor costs may lessen for non-residential construction projects, benefiting hotel development.

Hotel Development Cost Survey Results

As numerous developers will attest, and consistent media stories have reported, construction costs are up and continue to increase. Hotel development projects are as vulnerable as any other form of construction to the increased charges for materials and labor. In reviewing the results of last year's development cost survey, the high and low costs per room for the five categories had not been surpassed by newer project budgets. New per-room cost peaks were the result of construction projects in New York. To account for cost increases as if the same projects were to be developed in 2005, the component costs have been increased based on published data, and input from developers.

**Table 2 – 2005 Hotel Development Cost Survey Per-Room Averages**

| | Land | Building and Site Improvements | Soft Costs | FF&E | Pre-Opening and Working Capital | Total |
|------------------------------------|-----------|-----------------------------------|------------|----------|---------------------------------------|-----------|
| Budget/Economy Hotels | | | | | | |
| Average | \$15,200 | \$46,300 | \$4,400 | \$8,600 | \$3,100 | \$68,600 |
| Median | \$14,500 | \$42,100 | \$2,300 | \$8,600 | \$2,900 | \$55,500 |
| Allocation | 16% | 67% | 5% | 16% | 7% | |
| Midscale Hotels w/o F&B | | | | | | |
| Average | \$17,600 | \$72,300 | \$12,200 | \$10,100 | \$4,200 | \$107,900 |
| Median | \$14,800 | \$63,900 | \$8,800 | \$9,800 | \$2,800 | \$90,400 |
| Allocation | 16% | 67% | 10% | 11% | 5% | |
| Extended-Stay Hotels | | | | | | |
| Average | \$16,200 | \$84,700 | \$12,700 | \$13,600 | \$3,400 | \$142,900 |
| Median | \$14,400 | \$74,300 | \$11,000 | \$14,000 | \$2,500 | \$114,500 |
| Allocation | 13% | 63% | 10% | 12% | 2% | |
| Midscale Hotels w/ F&B | | | | | | |
| Average | \$18,500 | \$79,900 | \$14,400 | \$13,200 | \$3,900 | \$124,500 |
| Median | \$13,600 | \$65,900 | \$11,300 | \$12,400 | \$3,100 | \$106,700 |
| Allocation | 14% | 64% | 11% | 13% | 3% | |
| Full-Service Hotels | | | | | | |
| Average | \$21,700 | \$127,500 | \$25,200 | \$23,600 | \$7,100 | \$228,100 |
| Median | \$17,100 | \$115,800 | \$15,800 | \$19,300 | \$5,900 | \$171,300 |
| Allocation | 11% | 64% | 12% | 13% | 4% | |
| Luxury Hotels and Resorts | | | | | | |
| Average | \$108,300 | \$368,500 | \$117,900 | \$57,800 | \$21,900 | \$675,100 |
| Median | \$110,700 | \$319,600 | \$101,400 | \$61,700 | \$19,700 | \$607,100 |
| Allocation | 18% | 53% | 16% | 12% | 5% | |

Source: HVS International


Table 3 – Hotel Development Cost Survey Per-Room Range of Costs for 2003 - 2005

| | Land | Building and Site Improvements | Soft Costs | FF&E | Pre-Opening and Working Capital | Total |
|---------------------------|--------------------|--------------------------------|------------------|--------------------|---------------------------------|----------------------|
| 2005 | | | | | | |
| Budget/Economy Hotels | \$4,300 - \$27,400 | \$25,300 - \$77,600 | \$600 - \$12,600 | \$4,200 - \$15,900 | \$1,300 - \$6,600 | \$36,000 - \$121,100 |
| Midscale Hotels w/o F&B | 700 - 35,700 | 43,600 - 148,800 | 2,100 - 37,700 | 5,200 - 21,000 | 800 - 23,000 | 56,200 - 335,400 |
| Extended Stay Hotels | 2,500 - 46,700 | 49,900 - 155,500 | 2,100 - 43,800 | 3,300 - 21,400 | 600 - 11,000 | 61,900 - 222,700 |
| Midscale Hotels w/ F&B | 3,800 - 58,600 | 44,200 - 131,300 | 3,200 - 43,000 | 6,200 - 32,100 | 100 - 17,500 | 64,200 - 260,700 |
| Full-Service Hotels | 3,800 - 102,400 | 46,800 - 268,600 | 2,200 - 74,400 | 7,800 - 42,400 | 1,700 - 29,900 | 86,400 - 373,700 |
| Luxury Hotels and Resorts | 13,500 - 243,400 | 181,400 - 1,291,600 | 25,000 - 226,700 | 32,000 - 109,800 | 9,900 - 46,000 | 371,000 - 1,490,900 |
| 2004 | | | | | | |
| Budget/Economy Hotels | \$4,100 - 25,400 | \$22,000 - \$69,300 | \$600 - \$12,200 | \$4,100 - \$15,300 | \$1,300 - \$6,400 | \$32,700 - \$109,100 |
| Midscale Hotels w/o F&B | 4,100 - 33,100 | 37,900 - 132,900 | 2,000 - 36,600 | 5,000 - 20,200 | 800 - 22,300 | 51,100 - 190,100 |
| Extended Stay Hotels | 2,400 - 44,500 | 43,400 - 138,800 | 2,000 - 42,500 | 3,200 - 20,400 | 600 - 10,700 | 57,300 - 198,800 |
| Midscale Hotels w/ F&B | 3,600 - 53,300 | 38,400 - 163,300 | 3,100 - 41,700 | 6,000 - 30,600 | 1,000 - 17,000 | 57,300 - 237,000 |
| Full-Service Hotels | 3,500 - 93,100 | 50,800 - 233,600 | 2,100 - 72,900 | 7,600 - 40,400 | 1,700 - 29,300 | 77,100 - 339,700 |
| Luxury Hotels and Resorts | 12,900 - 231,800 | 157,700 - 1,123,100 | 24,300 - 222,300 | 31,100 - 104,600 | 9,700 - 45,100 | 343,500 - 1,406,500 |
| 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 |
| 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 |
| 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 |
| 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 |
| 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 |
| 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 |



Compared with the prior year's survey, new highs and lows reflect changes in construction costs and geographical expansion of product types. The proposed development of lower-rated limited-service hotels in tertiary markets resulted in a lower range of land cost per room for midscale hotels without food and beverage. Conversely, a similar product is proposed for Manhattan, where land and construction costs are significantly higher, setting a new high end for the cost range of the same product type.

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 International 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 table below are from per-room budgets for 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 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 International in 1987 as a Director in the San Francisco office. Elaine assumed responsibility for the Hotel Development Cost Survey in 1998.

Elaine can be contacted by E-mail at esahlins@hvsinternational.com, or by telephone at +1 415 268-0347