

2003



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# 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 2003 hotel development survey reports updated per-room development costs for 2002.

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. Thus, since more costly urban hotels have been constructed late in this development cycle, the range of cost per room for each construction category has continued to increase. Overlaying the increasing range of development costs is the general downward trend in many cost components resulting from the economic slowdown. As a result of these concurrent trends, many of the lower end of the per-room ranges have shifted upward significantly since the last survey.

In preparing the 2003 Hotel Development Cost Survey, two distinct influences that affected hotel development costs are worth noting: one, the movement in unit prices of major construction components, and two, the economics of the current hotel development cycle.

According to industry sources, the volume of all real estate construction in 2002 was relatively on par with that of 2001. Whereas the dollar amount of real estate under development was equivalent in 2002 and 2001, a higher percentage of the volume was in residential construction, while commercial construction, particularly that of office buildings, declined. Because of the fall-off in office building construction, which requires large amounts of construction materials such as structural steel, the cost of many materials used in the construction



industry was below that of last year. The competition for construction jobs was more pronounced than in the recent past. As contractors and their subs traveled further for work, they accepted lower contracts and wages and offered discounted raw material pricing. The slowdown in the pipeline for future construction also made the design and engineering professions more competitive. Fees for projects continued to be discounted. Those hotel projects that benefited most from this trend were the mid-scale and full-service hotel products, as the less complex economy/budget and limited-service hotels do not require the same level of construction or planning.

The most notable increase in construction cost was the implementation of the union wage settlement in 2001. But, at the same time that union wages increased, by 4.2% in 2002 compared to 2001, the cost of construction materials decreased. Lumber and structure prices declined in response to lower demand for new construction. In addition, less demand for construction labor and excess inventories of construction materials continued to suppress construction costs. All of the issues affected hotel development costs as a sub-segment of commercial development. As a result, hotel development costs did not increase as rapidly as in prior years, and in some cases even declined.

Looking back at 2002, most real estate investors would agree that interest in new hotel development cooled. Our industry is in the waning years of a hotel development cycle that effectively ramped up with the economic recovery in the mid-1990s. With improving hotel performance beginning in 1994 and 1995, new hotel projects began hitting the drawing boards. As would be expected, the first projects to be built were economy/budget and limited-service hotels in markets with low barriers to entry. These projects were completed within 8 to 12 months and stabilized their operations very rapidly. In the late 1990s, average rates continued to increase at above-inflationary growth, spurring developers to envision more and more complex properties. The more complex the project and the greater the development challenges, the longer its development time and the higher its costs. Average rates in many markets rose enough to justify the development of new, complex full-service and resort properties. Much of the product that was being built in markets with higher barriers to entry was conceived during the peak hotel performance period of 1996 to 2000. Due to numerous development issues, including environmental concerns, financing challenges, and changing market conditions, many of these hotels are now only being realized. The costs of delay translate into higher development costs. Consistent with the high barriers to entry and the development hurdles, the land and soft costs associated with these projects motivated developers to increase the scope of the improvements, spiraling construction costs in an upward direction.

With the lack of readily available financing and the general decrease in hotel operating results since 2001, the overall number of proposed hotel projects in



2002 declined. With little financing available for new hotel construction, many projects were stalled, postponed, or reconceived as other types of real estate. The number of new hotel starts in 2002 was less than half of those in 1999. While the type of property and the locations being developed in 2002 meant higher-priced projects, trends in overall construction indicate lower cost levels in general.

In 2002, the hotel development cycle became more challenging and more risky. Some markets remain viable for new supply that accommodates a specific niche. Many markets, however, are still recovering from the double blows of the economic recession and the events of September 11th. Some hotel developers are rethinking their development strategies for designated hotel sites. Land that may have penciled as a hotel project in the late 1990s may now be slated for other commercial construction, including office, multi-family residential, and/or mixed-use development.

As a result of these cyclical trends, some development costs, particularly land values, declined in 2002 in markets that were still absorbing new supply and recovering from deteriorated operating trends. For markets that were still thriving or were not as severely impacted, development costs and land prices increased.

The following tables set forth the overall results of the 2003 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.

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. ■

***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 join Security Pacific in San Francisco, 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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## 2003 Hotel Development Cost Survey Per-Room Averages for 2002

	Land	Building and Site Improvements	Soft Costs	FF&E	Pre-Opening and Working Capital	Total
<b>Budget/Economy Hotels</b>						
Average	\$8,000	\$33,400	\$1,400	\$7,100	\$2,800	\$52,800
Median	7,900	32,000	900	7,000	2,600	51,200
Allocation	15%	68%	3%	15%	6%	
<b>Midscale Hotels w/o F&amp;B</b>						
Average	12,600	52,100	8,900	9,900	4,700	85,600
Median	11,700	48,600	6,500	9,200	4,500	81,300
Allocation	15%	65%	9%	12%	5%	
<b>Extended-Stay Hotels</b>						
Average	15,700	67,500	11,100	13,000	3,100	111,500
Median	14,300	63,800	10,300	13,300	2,500	103,500
Allocation	14%	65%	9%	14%	5%	
<b>Midscale Hotels w/ F&amp;B</b>						
Average	14,900	63,400	12,300	11,800	3,900	103,100
Median	12,500	57,200	10,900	11,400	3,400	92,600
Allocation	14%	65%	12%	13%	4%	
<b>Full-Service Hotels</b>						
Average	21,200	102,100	21,600	20,300	7,300	165,900
Median	19,900	95,500	18,300	18,400	6,200	156,300
Allocation	13%	65%	10%	13%	5%	
<b>Luxury Hotels and Resorts</b>						
Average	81,500	245,500	76,100	66,000	21,800	516,300
Median	69,400	223,000	57,900	50,900	21,000	480,400
Allocation	17%	53%	17%	13%	5%	

Source: HVS International

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.



### 2003 Hotel Development Cost Survey Per-Room Range of Costs for 2002

2002	Land		Building and Site Improvements		Soft Costs		FF&E		Pre-Opening and Working Capital		Total	
	Budget/Economy Hotels	\$4,500	- \$14,100	\$20,800	- \$51,800	\$400	- \$4,100	\$2,900	- \$14,700	\$1,100	- \$5,300	\$32,900
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
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
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
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
Luxury Hotels and Resorts	36,000	- 128,300	150,200	- 322,900	32,900	- 140,400	44,300	- 98,300	15,100	- 28,500	353,300	- 804,000

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