GLOBAL HOSPITALITY

Focus on Hotel Construction Costs 2017

CUSHMAN & WAKEFIELD

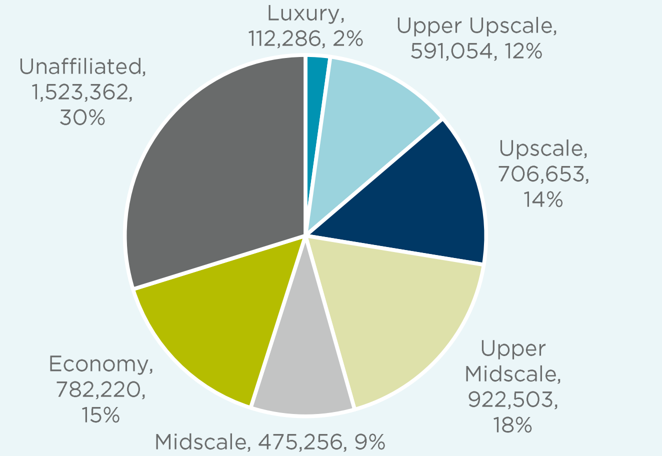
Last year, 2016, marked a year of transition for the overall U.S. hotel market, as the major performance indicators of occupancy and rate growth moderated, and new hotel development accelerated. The hotel pipeline remains robust as new hotels are constructed and proposed for many markets across the country. With a wider range of available brands and incentives for new hotels, development is flourishing in both the top 25 markets (as defined by Smith Travel Research) and in secondary and tertiary locations.

The feasibility of a new hotel is driven by a number of factors, foremost among them - the availability of sites, the costs to build, the price and accessibility of financing, and the demand for hotel rooms at a rate that supports all these and other elements.

Cushman & Wakefield's Valuation & Advisory Hospitality & Gaming Practice Group provides consulting and valuation services for new and existing hotel properties across the globe. This presentation focuses on U.S. hotel development. In recent years, the majority of new hotel projects we have worked on have fallen into the STR chain scales defined for Upper Midscale, Upscale, and Upper Upscale brands. We are also seeing projects coming to fruition in the luxury segment that have a longer and more challenging development process. Midscale hotel development is also more in evidence than in prior years. Construction data for the Economy segment remains the sparsest, as these hotels are less feasible to build due to relatively high construction costs and land values. It is also interesting to note as we move up the chain-scales, the hard construction and FF&E components decline as a percentage of the total cost and soft costs generally increase as luxury hotel products are typically developed in urban and resort locations with high barriers-to-entry.

Hotel Supply has been steadily growing as substantial new hotel properties continue to be proposed for many markets across the U.S. The growth in brands, hotel company consolidations and design shifts provide developers with more choices than ever for new hotel products. The current inventory of hotel rooms in the U.S., based on the STR Chain Scale distribution, is categorized in the following chart.

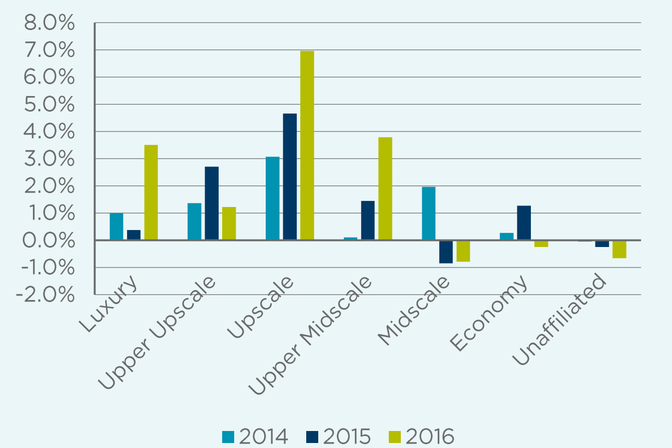
U.S. Hotel Rooms by STR Chain Scales



Source: STR
Republication or Other Re-Use of this Data Without the Express Written Permission of STR is Strictly Prohibited
Based on 2016 data
Cushman & Wakefield Global Hospitality

The pipeline has indeed accelerated but not uniformly across the STR Chain Scales. Some products have shown higher rates of growth while the pipeline for other segments has contracted. The following chart shows the annual rate of change of hotel rooms as a percentage of all new supply since December 2013.

Annual Percentage Change by STR Chain Scales



Source: STR
Republication or Other Re-Use of this Data Without the Express Written Permission of STR is Strictly Prohibited
Based on 2016 data
Cushman & Wakefield Global Hospitality

GLOBAL HOSPITALITY

Focus on Hotel Construction Costs 2017

CUSHMAN & WAKEFIELD

Hotel Construction Costs – based on 2016 data	Midscale	Upper Midscale	Upscale	Upper Upscale	Luxury
Land					
Min Per Room	$10,000	$4,000	$5,000	$7,000	$17,000
Max Per Room	$30,000	$103,000	$163,000	$212,000	$1,067,000
Average	$20,000	$20,000	$32,000	$82,000	$240,000
Average % of Total Cost	16%	13%	13%	18%	9%
Hard Costs					
Min Per Room	$63,000	$49,000	$59,000	$120,000	$351,000
Max Per Room	$103,000	$197,000	$313,000	$377,000	$1,327,000
Average	$79,000	$94,000	$133,000	$232,000	$805,000
Average % of Total Cost	71%	66%	65%	61%	58%
Soft Costs					
Min Per Room	$500	$1,000	$2,000	$5,000	$88,000
Max Per Room	$34,000	$35,000	$102,000	$131,000	$515,000
Average	$16,000	$12,000	$16,000	$46,000	$308,000
Average % of Total Cost	11%	8%	7%	11%	20%
Working Capital, Pre-opening and Supplies					
Min Per Room	$100	$500	$500	$800	$3,100
Max Per Room	$100	$8,000	$13,000	$13,000	$52,000
Average	$100	$3,000	$5,000	$6,000	$20,000
Average % of Total Cost	1%	2%	2%	1%	1%
Furniture, Fixtures & Equipment (FF&E)					
Min Per Room	$8,000	$9,000	$10,000	$10,000	$53,000
Max Per Room	$10,000	$30,000	$36,000	$69,000	$162,000
Average	$10,000	$16,000	$20,000	$32,000	$101,000
Average % of Total Cost	9%	12%	11%	9%	8%
Development Fee					
Min Per Room	$6,700	$500	$400	$3,200	$10,200
Max Per Room	$8,000	$35,000	$38,000	$28,000	$80,000
Average	$7,000	$6,000	$9,000	$11,000	$57,000
Average % of Total Cost	6%	4%	4%	3%	3%
Total					
Min Per Room	**$87,000**	**$78,000**	**$91,000**	**$200,000**	**$524,000**
Max Per Room	**$166,000**	**$273,000**	**$527,000**	**$634,000**	**$3,078,000**
Average	**$115,000**	**$145,000**	**$207,000**	**$388,000**	**$1,515,000**

Based on 2016 data
Cushman & Wakefield Global Hospitality

*Note that when calculating the total average contribution of each component to the total cost over all the data, the overall percentages will not equate to 100%.

GLOBAL HOSPITALITY

Focus on Hotel Construction Costs 2017

As a percentage of the existing supply, luxury, upscale and upper midscale segments have shown the strongest growth while lower-rated properties have contracted. Note that some of the unaffiliated properties may have rebranded.

As some pundits have expressed, the U.S. hotel inventory is not oversupplied, but under-demolished, and the reduction of older, lower-rated or obsolete hotels can be considered part of this development cycle. Nevertheless, over 173,000 hotel rooms have opened since December 2013 with another 133,000 rooms under construction and expected to open in the next 12 to 24 months.

Using actual project data from actual budgets and other industry sources, Cushman & Wakefield has compiled per-room project costs for six major categories: (1) Land, (2) Hard Costs, (3) Soft Costs, (4) Working Capital, Pre-Opening and Supplies, (5) Furniture, Fixtures, & Equipment, and (6) Development Fee for three most prolific STR Chain Scale properties. Composite budget data from recent hotel projects is shown in the per room chart on the previous page. We have excluded the Economy chain scale due to insufficient data.

The data represent broad category ranges and should be used as a general guide only. The per-room data compiled by Cushman & Wakefield represents projects across the U.S.. Specific amounts from project budgets are sometimes difficult to validate as individual developers may account for the same items in different categories and geographical costs can vary over 100% from one part of the country to another. For example, it may cost more to build an Upper Midscale hotel in a major urban center than an Upper Upscale hotel in a secondary Midwest market. Without consistent cost budget categories, some development budget line items such as equipment and fixtures can bleed from one category to another. Materials or fixtures may be included in certain categories by developers based on their expected depreciation. We have established a consistent allocation of the items to the represented categories for this analysis.

The **land** components in the construction budgets are represented by different financial contributions as determined by the particular developers. Some land components are direct market-based site acquisitions while other property may have been purchased many years ago or inherited. Other developers assign a value to the land component as part of the equity of a project. On a national average basis, the land component averages 15 percent of the total budget.

Hard costs are the largest portion of hotel development and depending on the location and type of construction can vary widely for the same property type. Limited service hotel projects include wood-frame three story projects in secondary markets and steel frame Class A high rises in major urban areas. The range of these per-room costs are five times higher from the low- to high-end of the per-room range. Construction costs continue to escalate; Turner Construction reports building cost increases of between four to five percent annually in the last four years. Last year (2016), ENR construction industry reports opined that the industry overall was peaking, as the number of proposed development projects decelerated from prior years. Now participants are anticipating a post-election construction rebound responding to the pro-business sentiment of the new administration. More projects, however, mean more competition for materials and labor. Material costs are anticipated to increase moderately in 2017 but the shortage of skilled laborers continues to drive wages upwards. ENR reports that construction firms anticipate wage increases of over four percent in 2017, well about inflation expectations. Despite the presumed higher construction costs, builders are looking at a robust year in 2017.

Soft costs include entitlement and permit costs, financing costs, franchise fees, due diligence, legal, insurance, and property taxes. Financing costs, and sometimes entitlement costs, are typically the largest component of soft costs. Financing for hotel construction continues to be challenging to source and secure. Projects in urban and more environmentally sensitive areas often have high entitlement costs and longer pre-development periods with higher holding costs. Note that we include architectural and engineering fees in the hard cost category.

FF&E costs include guestroom and public space furniture and can include soft goods. Individual development budgets account for FF&E in different categories.

Focus on Hotel Construction Costs 2017

For example, we may be provided with budgets show carpeting, bathroom fixtures, laundry and kitchen equipment, and technology systems as hard costs, while other budgets include some of these items in the FF&E category. These differences contribute to the wide range of per-room amounts.

Working capital and pre-opening expenses are critical to the success of a property but are sometimes excluded from development budgets. The initial operating supplies and inventory and hiring of the pre-opening staff are a relatively small component of hotel development, ranging on average from 1 to 4 percent of the total budget. These costs are part of opening a hotel and experienced developers include in these costs the dollars expected to be spent on technical services, pre-marketing, staffing, and staring up the operating.

We also include a category for **development fee**. More and more, we are seeing an allocation of the project budget directly to the development team. The fee accounts for the costs of the ground work and administering of the project, including payroll, technical services, travel, and other expenses. The development fee is not related to any entrepreneurial incentive expected upon the successful completion of the construction.

Despite a moderation in national RevPAR growth, numerous markets across the U.S. continue to report positive performance trends. Feasible hotel development is a market by market prospect. The potential for successful hotel construction is now a micro analysis proposition. We are seeing demand for particular locations in particular submarkets and for specific hotel products and brands in numerous areas and are optimistic that well located, planned, and executed hotel projects can be continue to be considered in the current cycle

About The Author

Ms. Sahlins is a Managing Director in the Hospitality & Gaming practice of Cushman & Wakefield where she provides appraisal and consulting services for hotels and casinos. With over 25 years of experience, Ms. Sahlins has appraised thousands of hotel and gaming properties. A seasoned appraiser and consultant, Ms. Sahlins has performed valuations and market and feasibility studies of hotel and gaming properties throughout the United States. Previously a Managing Director of HVS in the San Francisco Office and a Senior Review Appraiser at Bank of America, Ms. Sahlins began her hotel real estate career in acquisitions at VMS Realty in Chicago. Ms. Sahlins' appraisal and consulting assignments span all types of hospitality and casino properties including select- and full-service hotels, destination resorts and gaming properties. She performs assignments for lenders, developers, attorneys, management companies and owners relating to financing, feasibility and other real estate issues. Ms. Sahlins is a designated Member of the Appraisal Institute (MAI) and The Counselors of Real Estate (CRE).

Hospitality & Gaming Practice Group

The Hospitality & Gaming Practice Group offers a full range of valuation, advisory, property tax and litigation support services. The team is distinguished by its combination of industry experience, local market knowledge, global coverage and responsive service. The Hospitality & Gaming Practice Group operates in four continents with offices across the globe. In addition, our staff of seasoned professionals has extensive experience and the ability to draw upon the diverse disciplines available from other Cushman & Wakefield core businesses, including Capital Markets, Consulting, Corporate Occupier & Investor Services and Leasing.

For more information, contact:
Elaine Sahlins, MAI, CRE, Managing Director
+1 415 773 3531 | elaine.sahlins@cushwake.com

Cushman & Wakefield Western, Inc.
201 California Street, Suite 800
San Francisco, CA 94111