

Where Are Development Costs Headed.... Up, Down, Maybe Both!

ULI Spring Council Meeting
May 11, 2006

Moderator

John R. Hardy
President / CEO
The John Hardy Group

Panelists

Scott Hazelton
Senior Consultant
Global Insights and WMRC

Martin B. Stringfellow
President
Martin B. Stringfellow Company

Contributors

Jack Corgel
Advisory Board
Cornell Hotel School

Mark Woodworth
Executive Vice President
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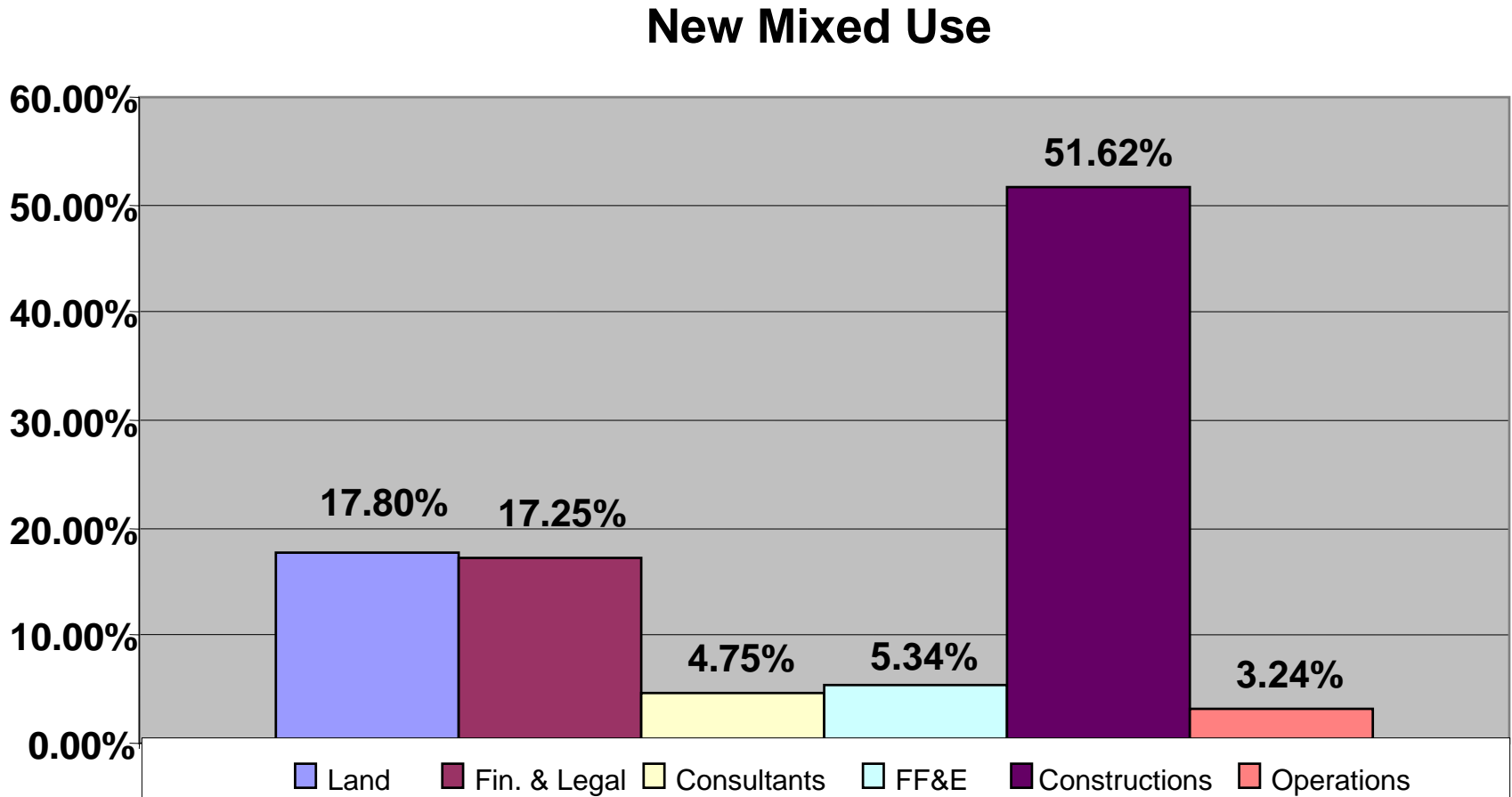


MARTIN B. STRINGFELLOW COMPANY

Development Cost Categories

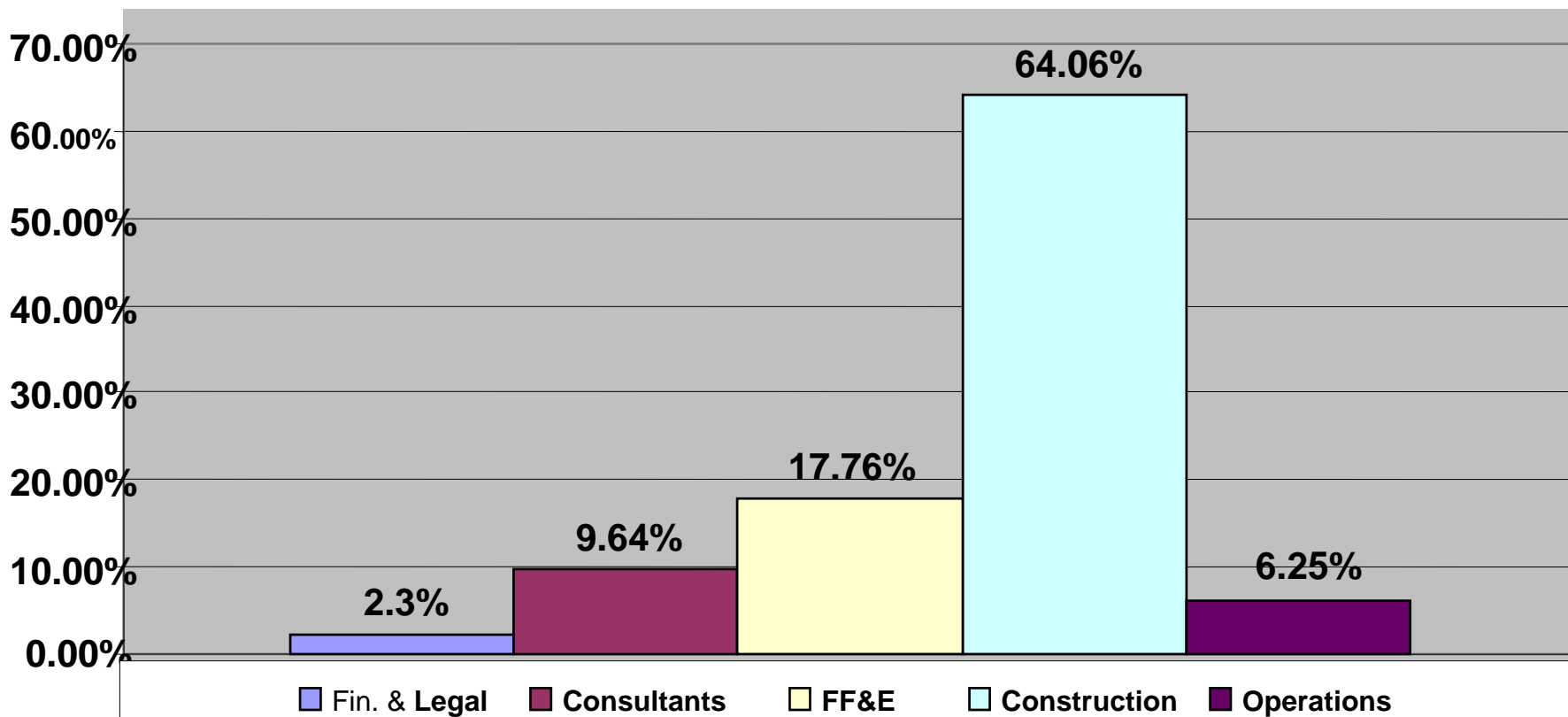
Land:	Jack Corgel
Consultants:	John Hardy
FF&E:	Martin Stringfellow
Construction:	Scott Hazelton
Technology:	John Hardy
OS&E:	John Hardy
Pre-Opening:	John Hardy
Contingencies:	All
Recommendations:	All

JHG's Category Costs As A % Of Total Development Costs



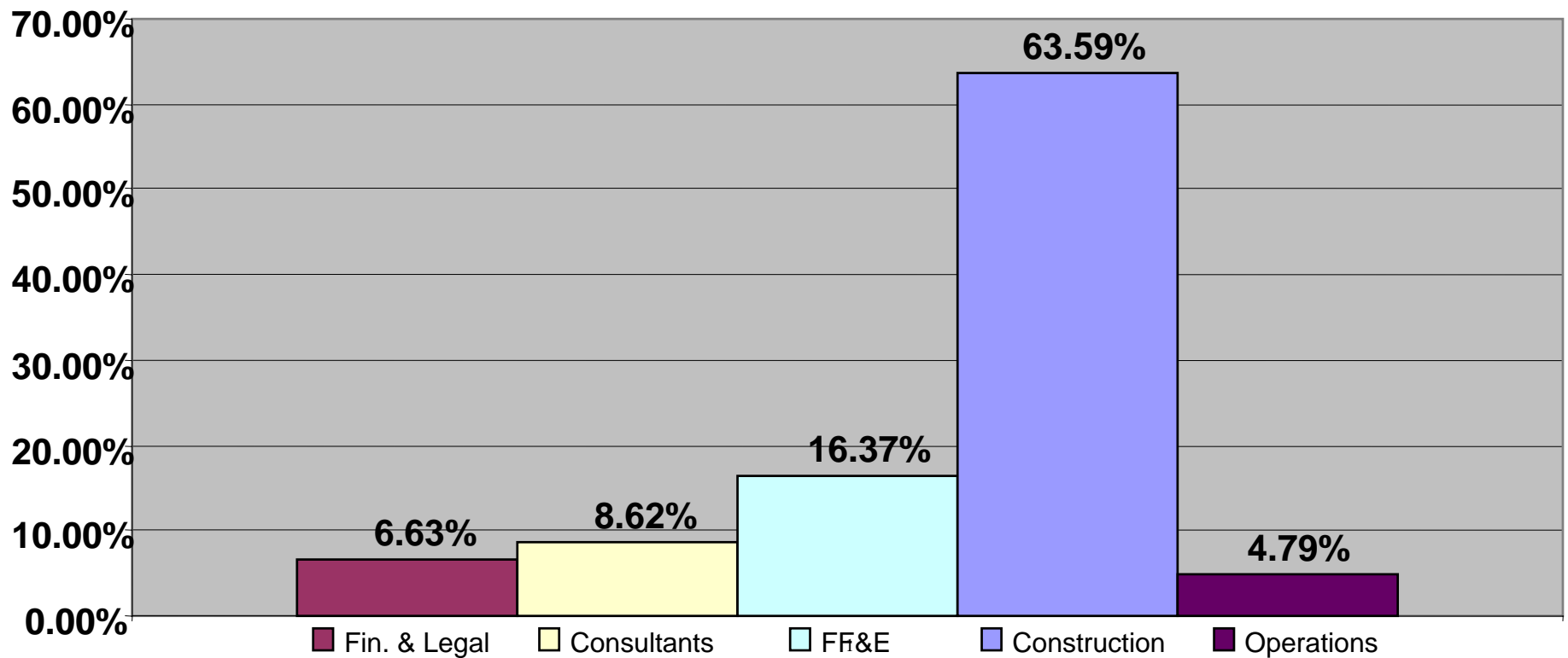
JHG's Category Costs As A % Of Total Development Costs

Renovations



JHG's Category Costs As A % Of Total Development Costs

Redevelopment



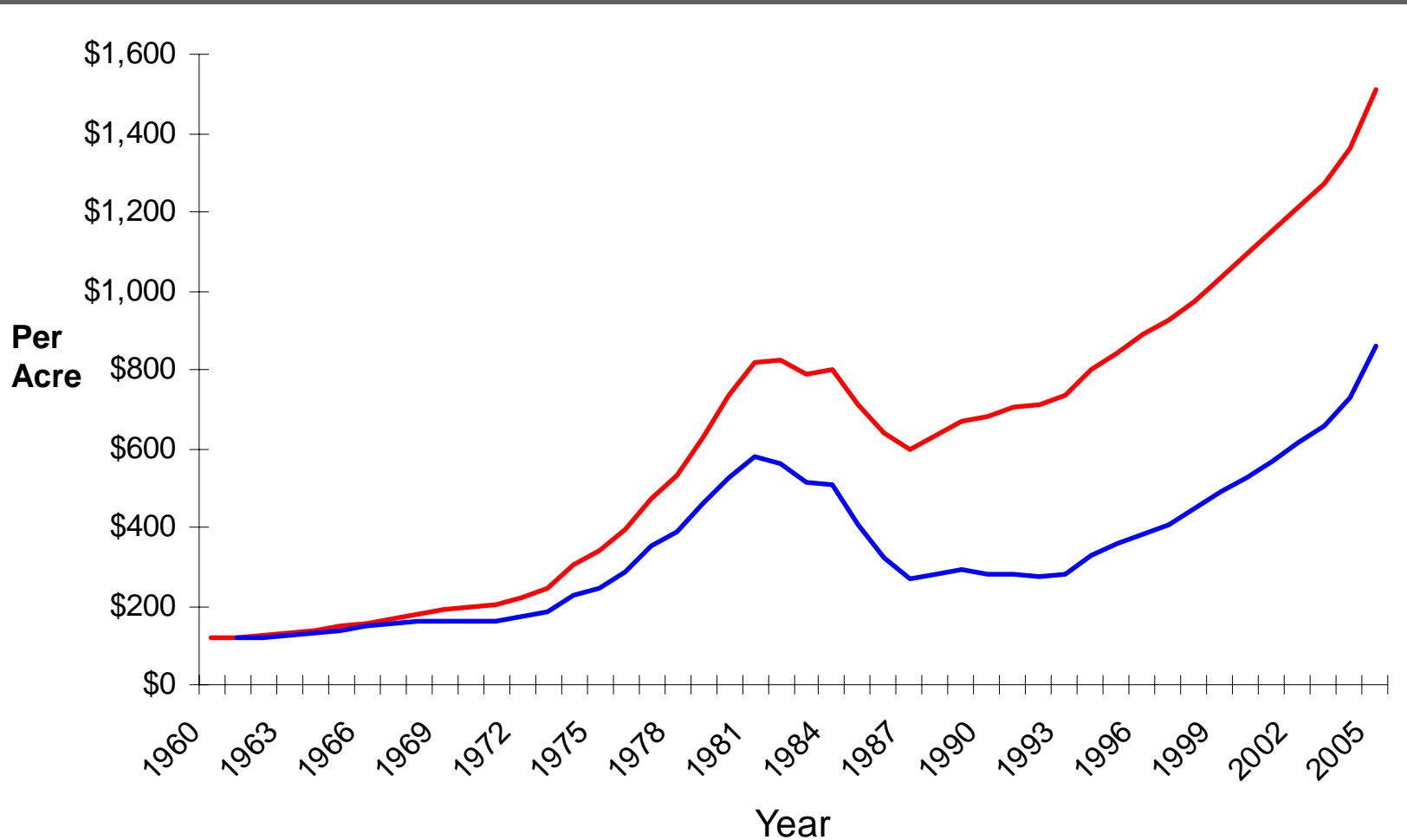


LAND

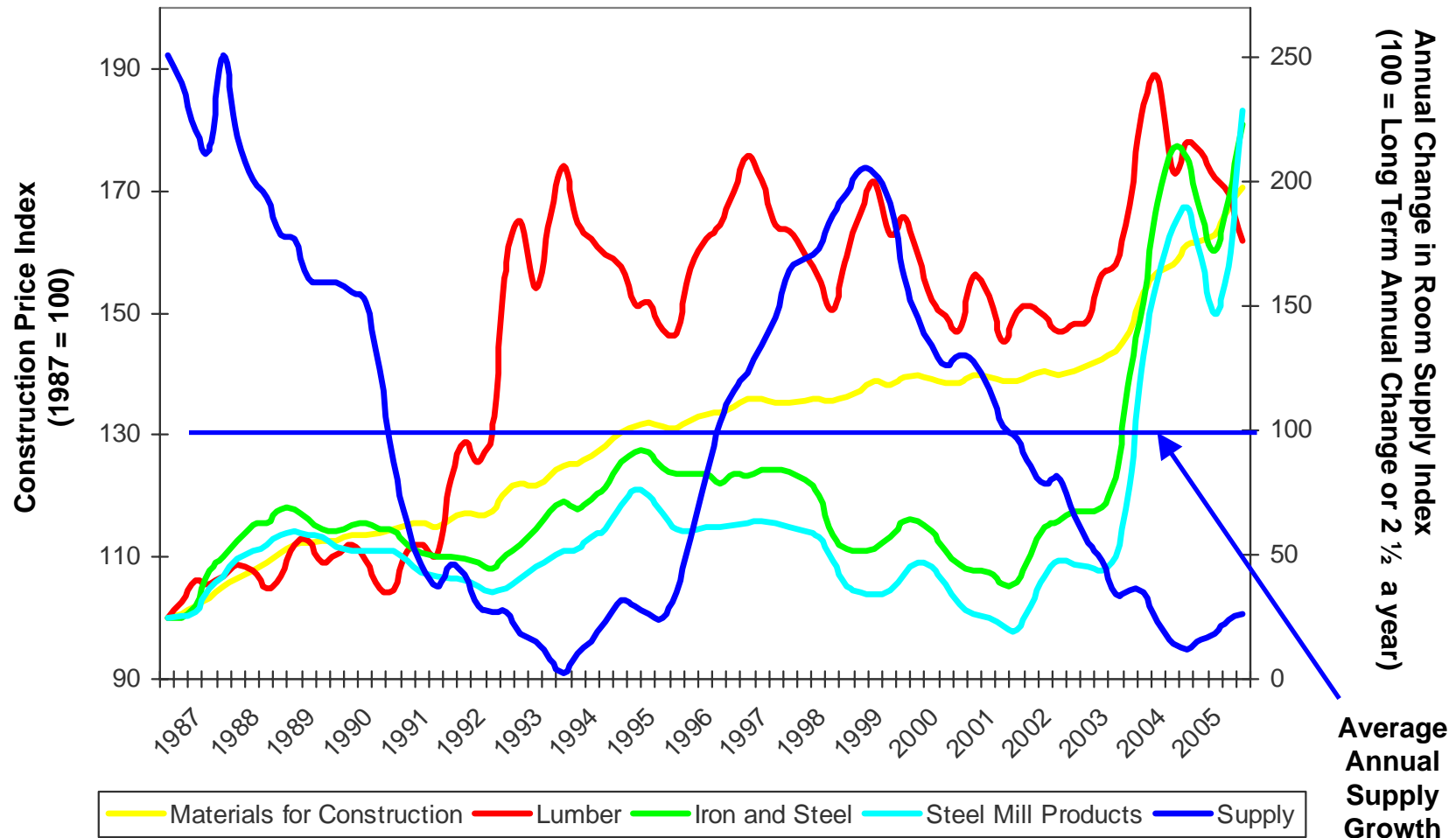
Jack Corgel
Advisory Board
Cornell Hotel School
&
Mark Woodworth
Executive Vice President
PKF Consulting

- ⇒ The US Dept of Agriculture data is the only time-series of land data available, they track farm land prices across every state. This is the US aggregate, latest update.
- ⇒ The slide shows long-term movement in nominal (upper line) and real-inflation adjusted (lower) farm land prices since 1960.
- ⇒ Prices took off in the late 1990s and continue to power because of the demand for land in residential use at the border of metro areas.
- ⇒ While we don't have data to verify, the evidence from high rise condo development activity (substitution of buildings for expensive land) indicates that land prices inside metro areas has experienced a similar rise.
- ⇒ There are now pension fund managers offering more and more raw land and timber land funds to investors.
- ⇒ All this points to the growing cost of land for hotel development, and it appears that land costs have been growing faster than other costs, especially labor.

Land Prices Become a Greater Share of Hotel Development Costs (Source: USDA)



Supply Growth Stymied Construction Costs are High





CONSULTANTS

John Hardy
President / CEO
The John Hardy Group

Consultants Survey

1200 Consultants Surveyed

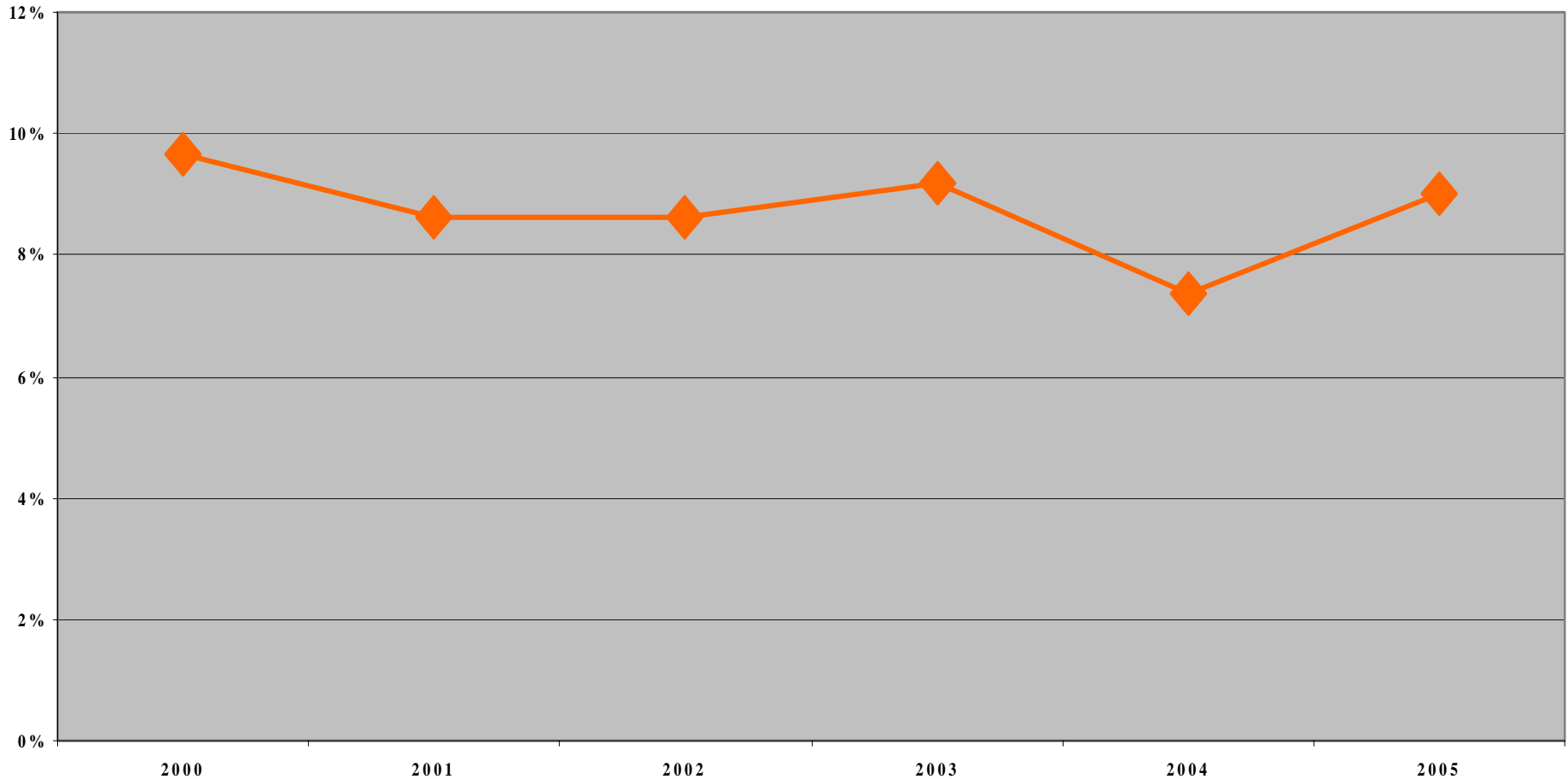
Based Upon Responses

The Analysis Suggests The Following:

From 2001 through 2005

- 32%** No Change in Fees
- 58%** 10% – 15% Increase Annually
- 10%** 25% and More Increase Annually

JHG's Consulting Costs As A % Of Total Development Cost

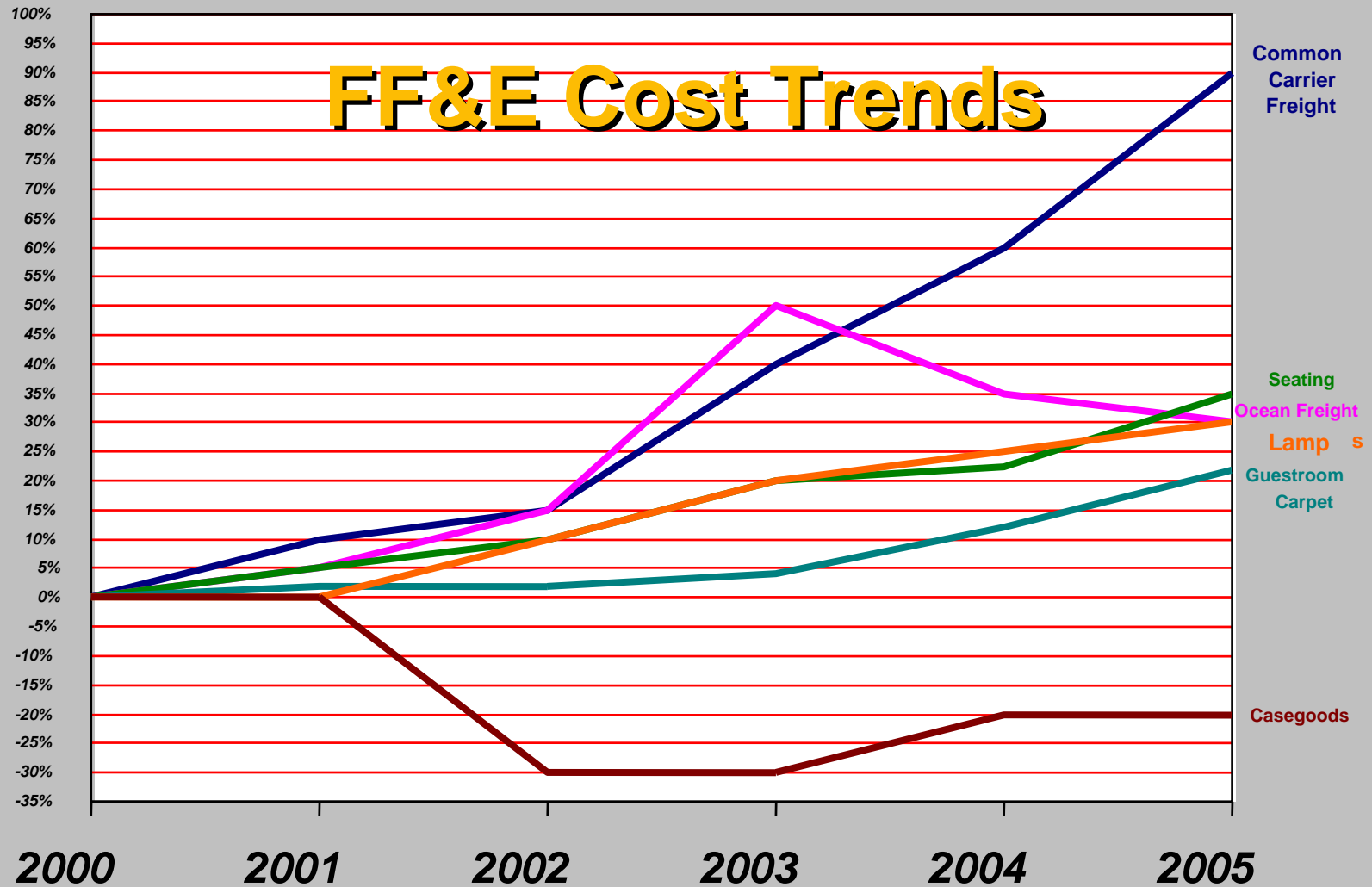




FF&E

Martin Stringfellow
President
Martin B. Stringfellow Company

FF&E Cost Trends



Common Carrier Freight

Ocean Freight

Seating

Guestroom Carpet

Lamps

Casegoods



Construction

Scott Hazelton
Senior Consultant
Global Insights and WMRC

Building Materials Prices: The Two-Handed Forecast

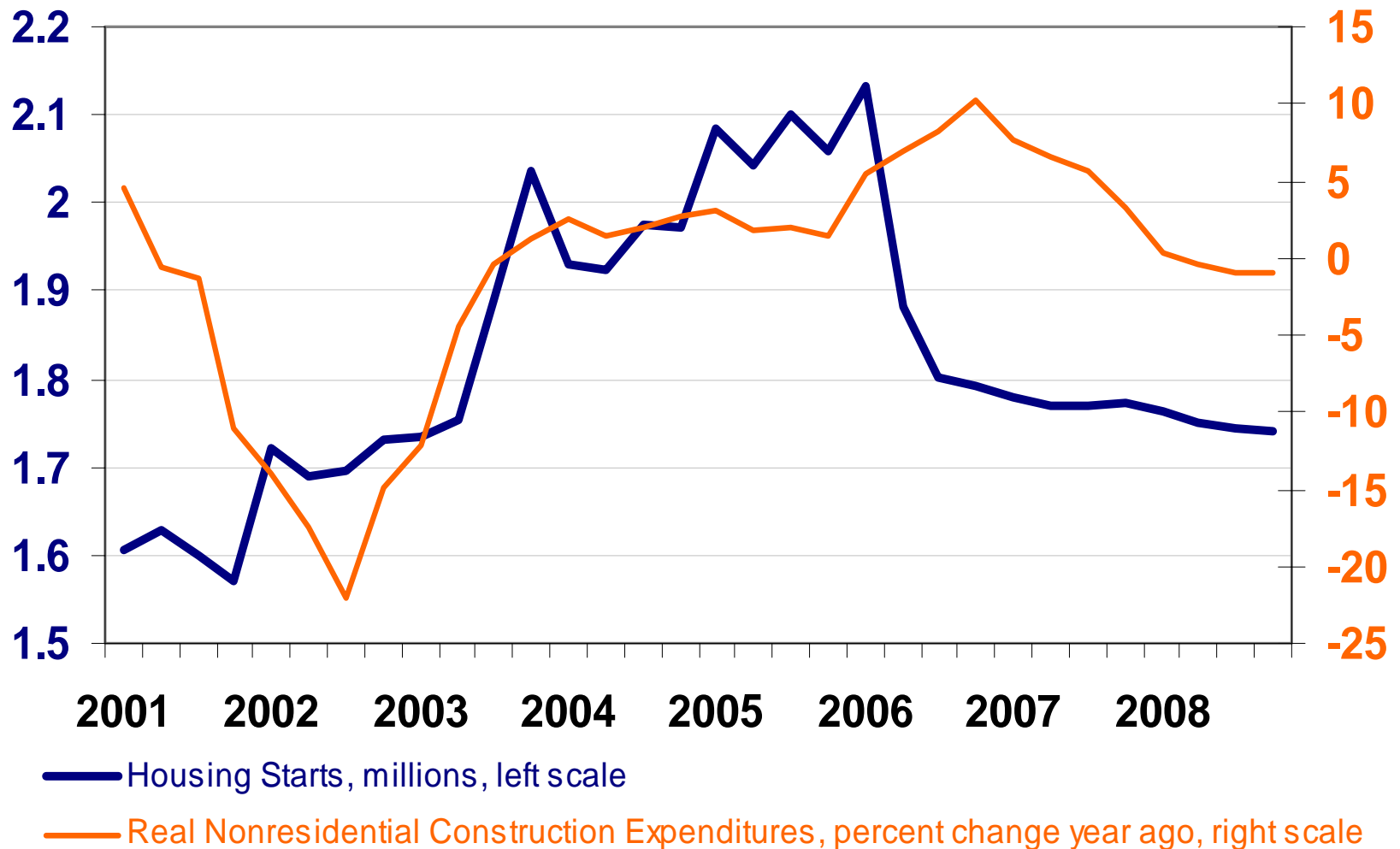
Bad News

- **Material prices rose by more than 8% in 2004 and by more than 6% in 2005**
- **Building material price increases will outpace inflation again in 2006**

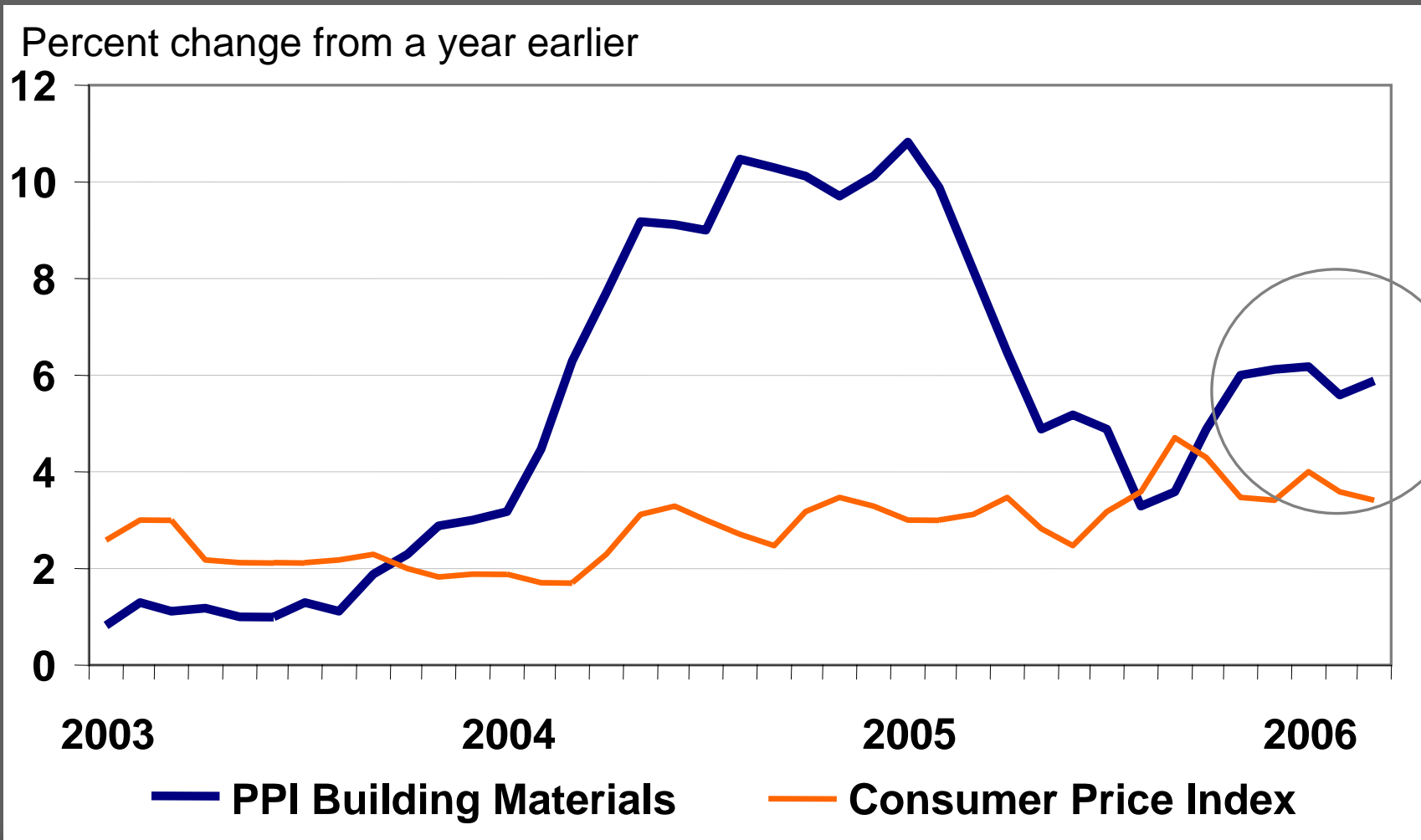
Good News

- **Pace of materials price escalation slows across 2006**
- **Collectively, building material prices look flat in 2007**

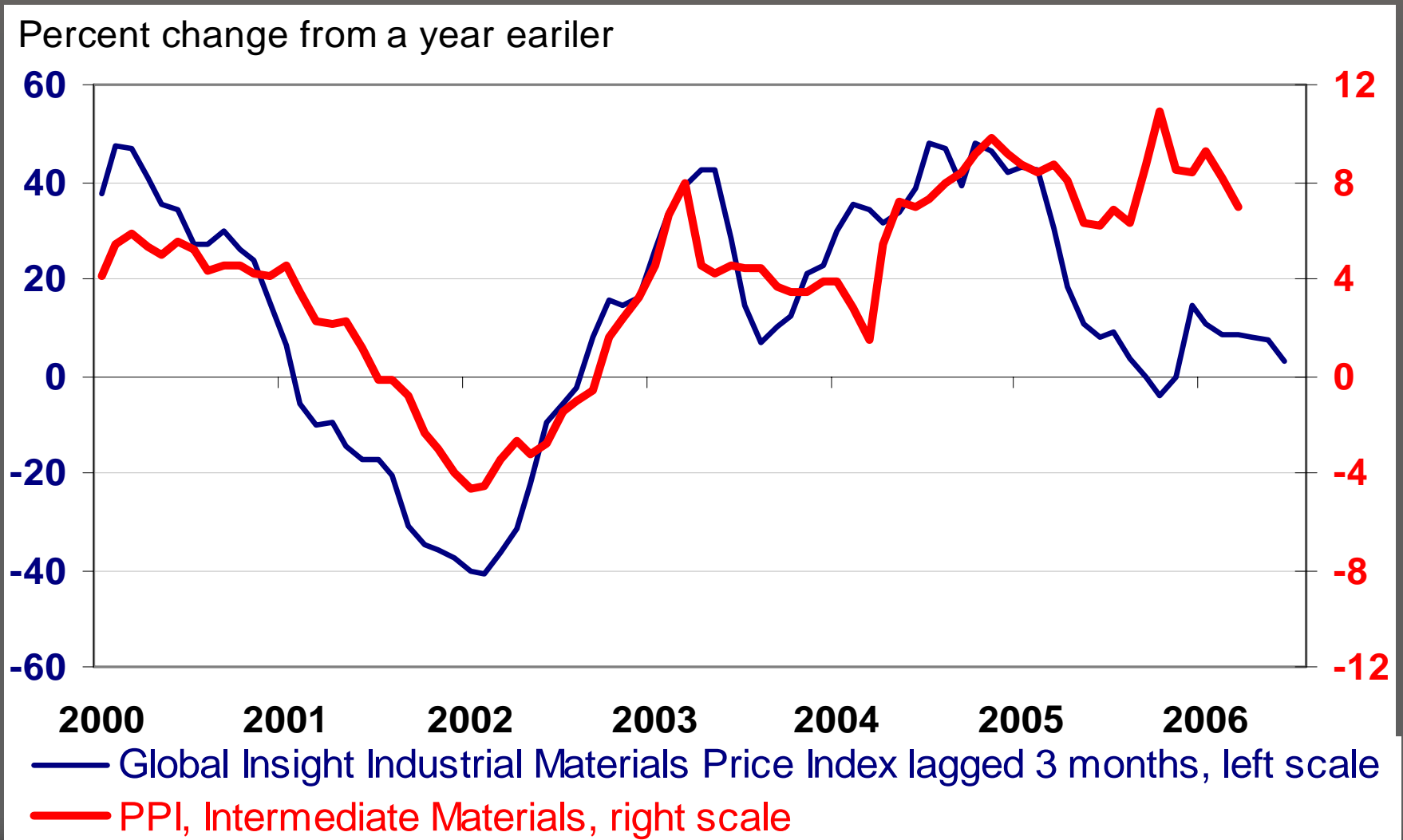
The Building Environment



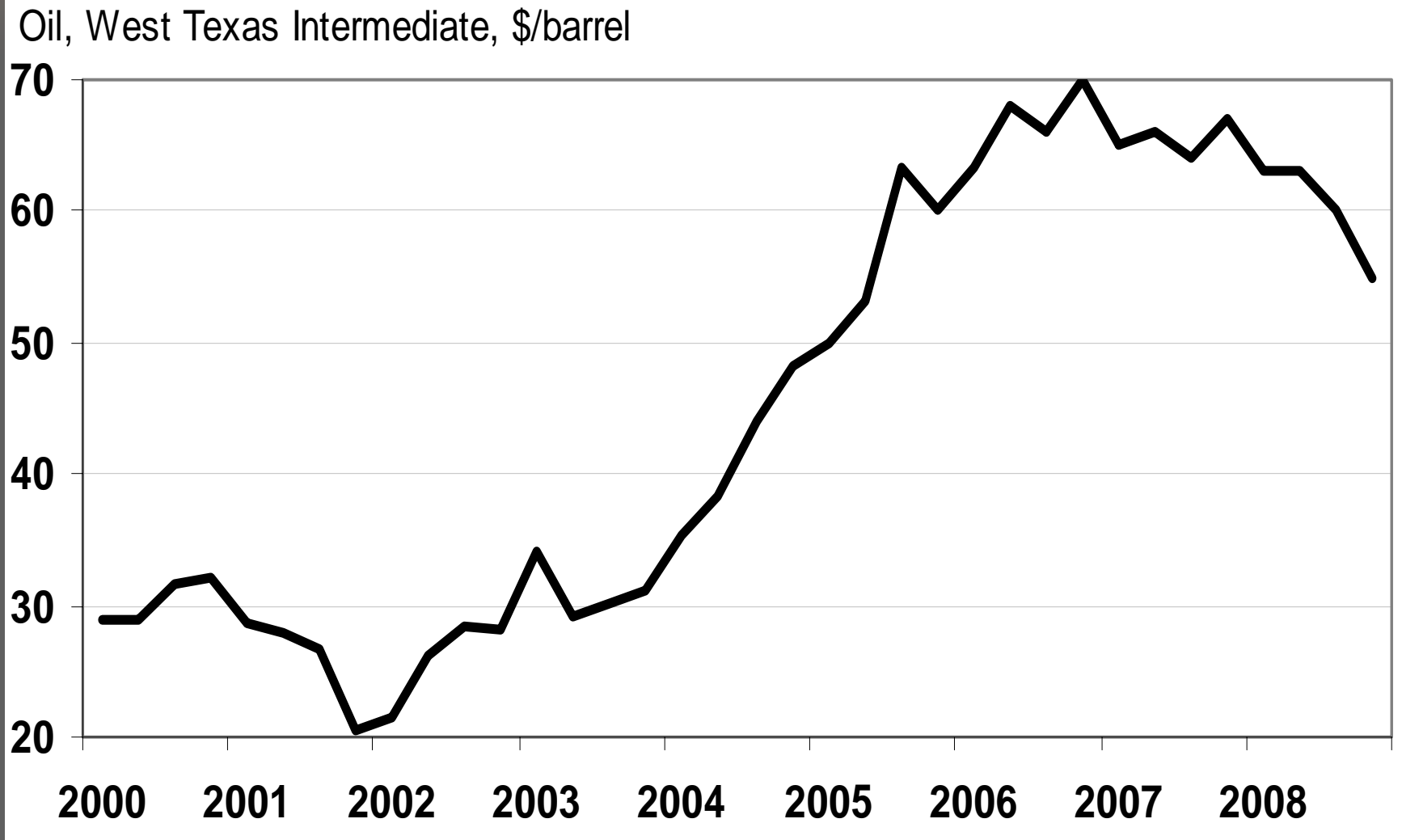
Material Price Escalation Remains Stubbornly High



Though Cost Pressures Deep Down in Supply Chains are Beginning to Unwind

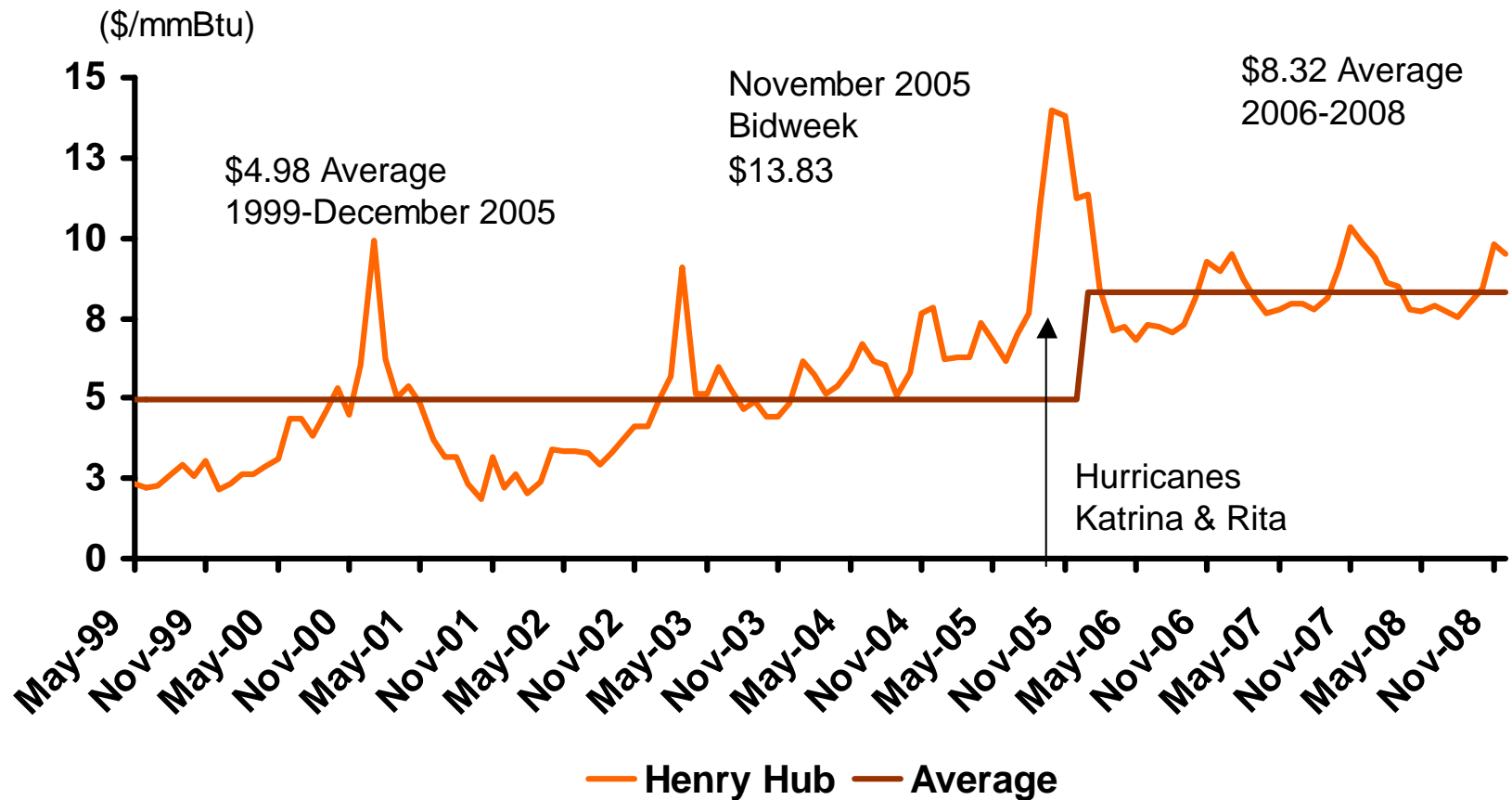


Oil Prices Do 'Ease' Eventually



Natural Gas Prices Have Moved to a New Plateau

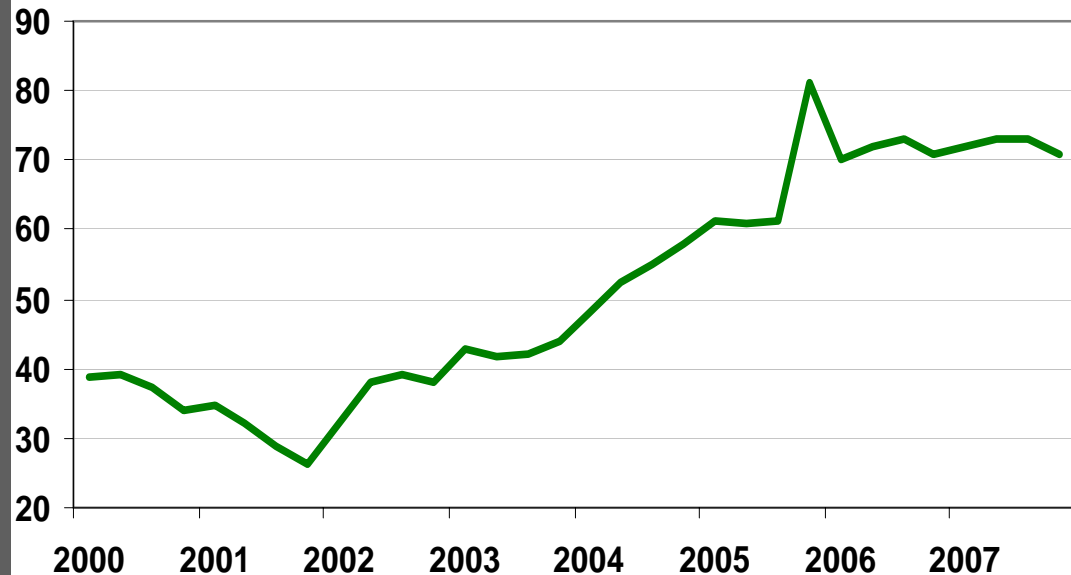
Henry Hub Price Volatility Reaches New Heights Post-Hurricanes



PVC

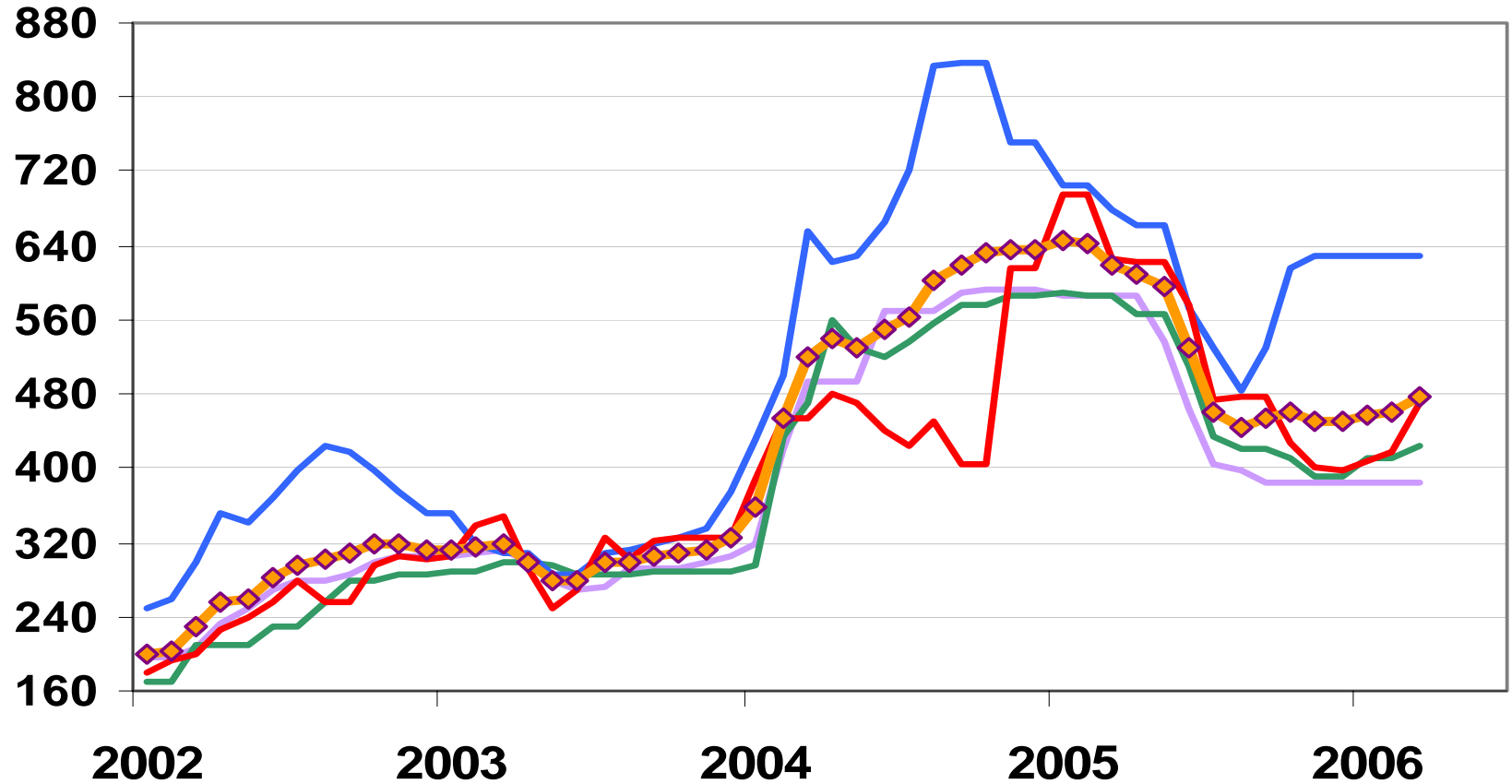
- ➔ Expect prices to remain elevated through 2007
- ➔ Higher post hurricane production and softer home building will be offset by...
- ➔ Strength in both ethylene and chlorine prices
- ➔ Potentially sharp price correction in 2008 and beyond because of capacity additions in N America and Asia

PVC, general purpose, estimated market price, cents/lb.



Steel Markets Have Stabilized

Hot Rolled Coil Steel \$/mt

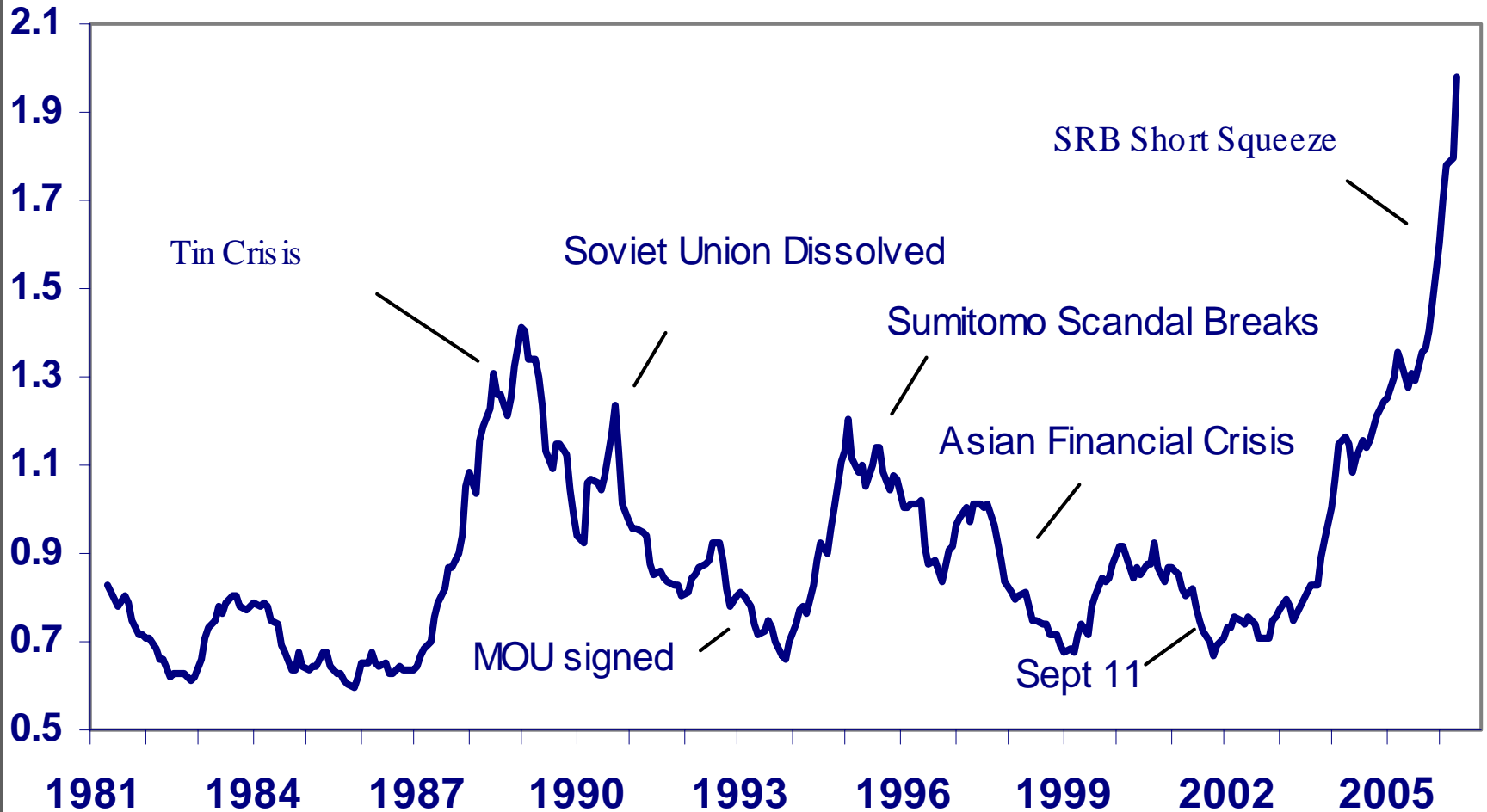


— Europe — Latin America — US — China —◇— World Avg

source: Metal Bulletin

Base Metals Bubble?

Global Insight Index of Primary Metals Prices (Avg 94-95=1.0)

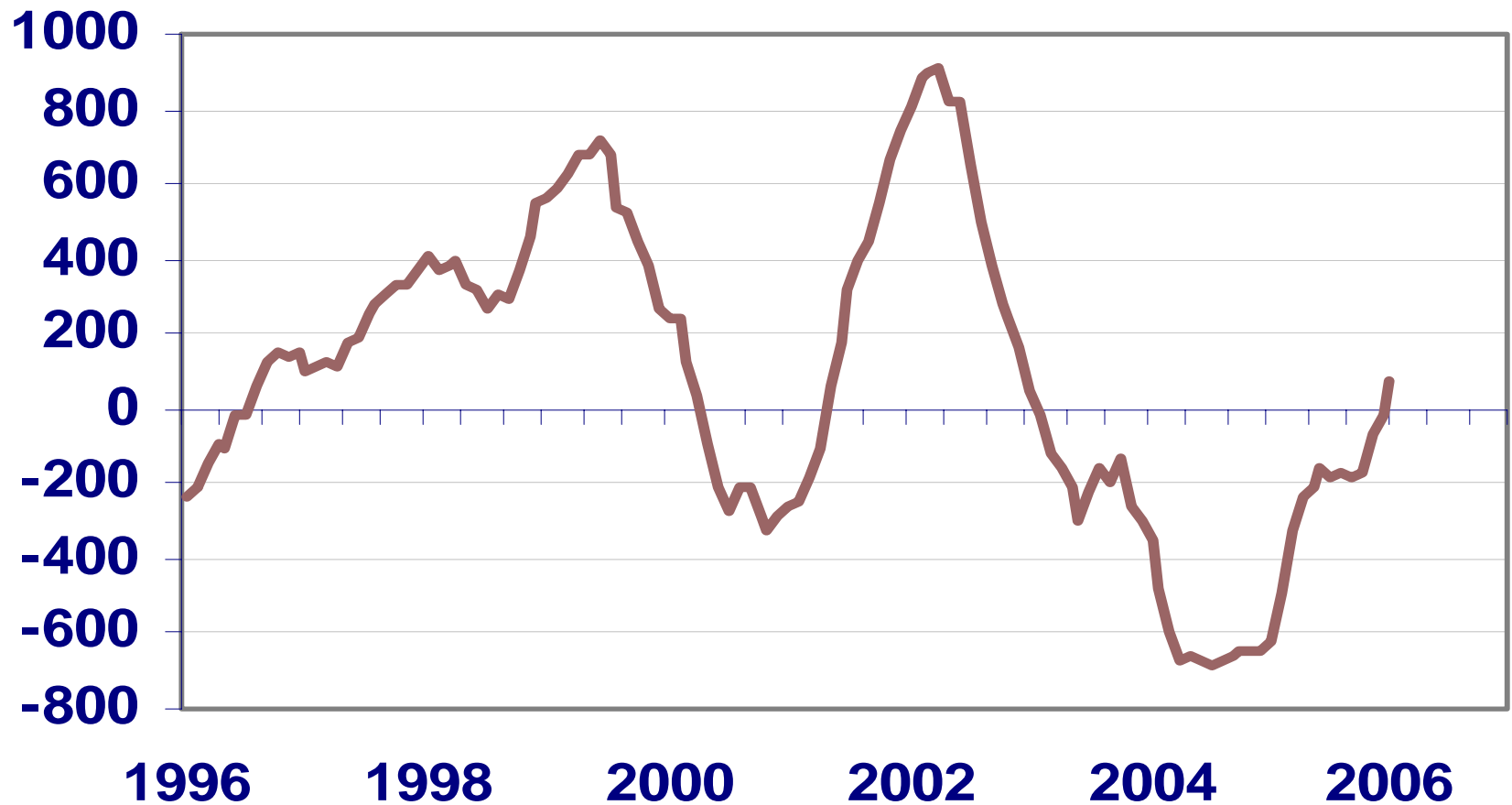


Base Metals – Copper, Aluminum,.....

- What is going on?
 - Prices are up 145% since 2002; 26% since January 1
 - How ridiculous can things get?
- Fundamentals are good
 - Inventories low
 - Production has been slow to ramp up
 - Consumption growth (China) has been strong
 - Concerns about possible supply disruptions
- But markets look to be in a better balance near-term
 - High prices are restraining consumption
 - Production will continue to increase

Copper Prices are at Record Levels – But the Market is Now in Surplus

12 Month Cumulative Copper Surplus/Deficit, 000's

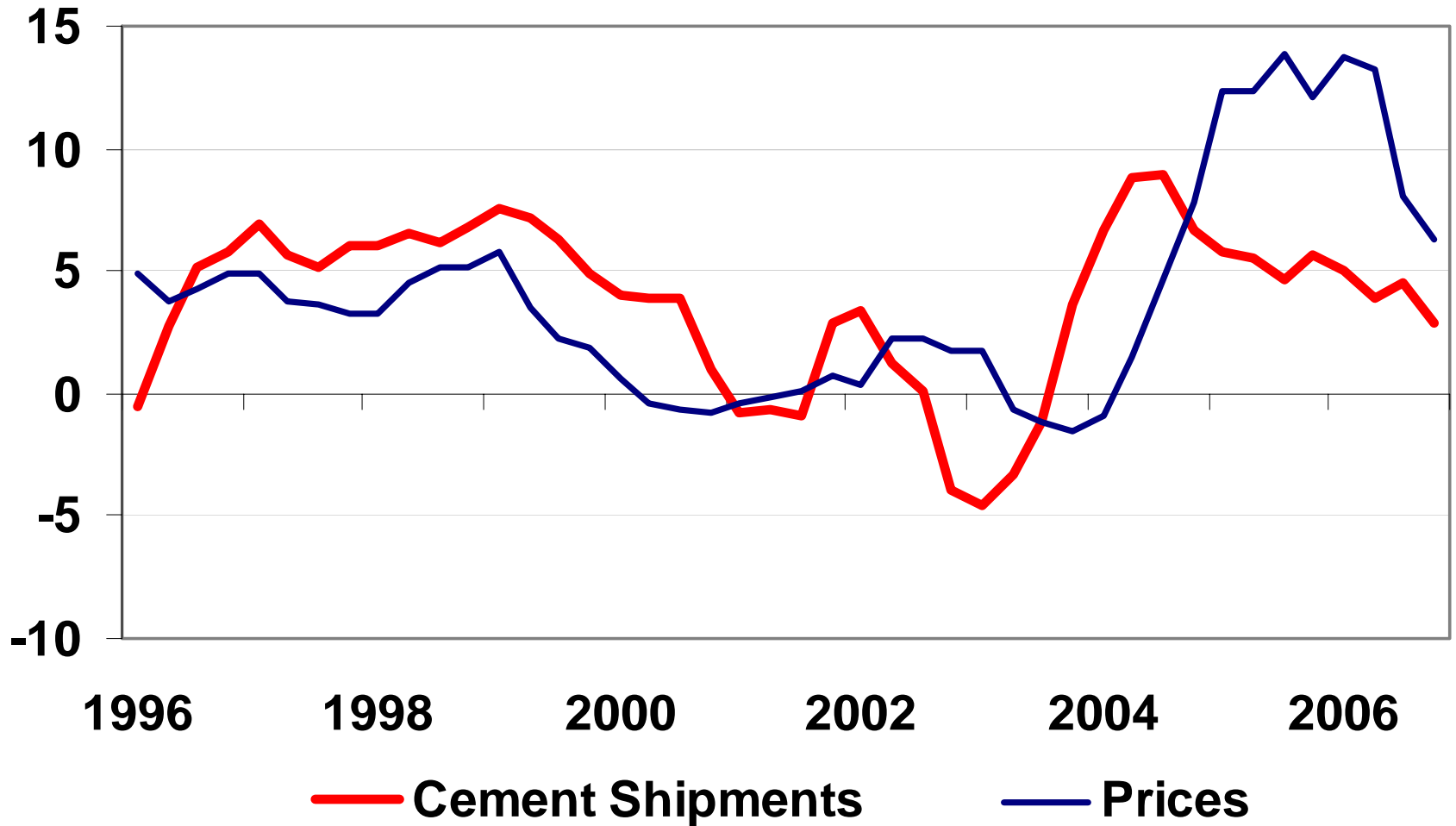


Cement – Hope Springs Eternal

- ⇒ Markets remained extremely good in 2005
 - Prices up another 12%
- ⇒ Sizeable clinker capacity additions are in the offing
 - Unfortunately, bulk of additions after 2007
- ⇒ Recent trade rulings on Mexican product promise to add 1 million mt in 2006
- ⇒ Possible added Chinese imports
- ⇒ Plus slower demand growth
- ⇒ Point to more ‘modest’ price increases in 2006
 - But we still expect prices by as much as 10% this year

Cement Price Increases Finally 'Cool'

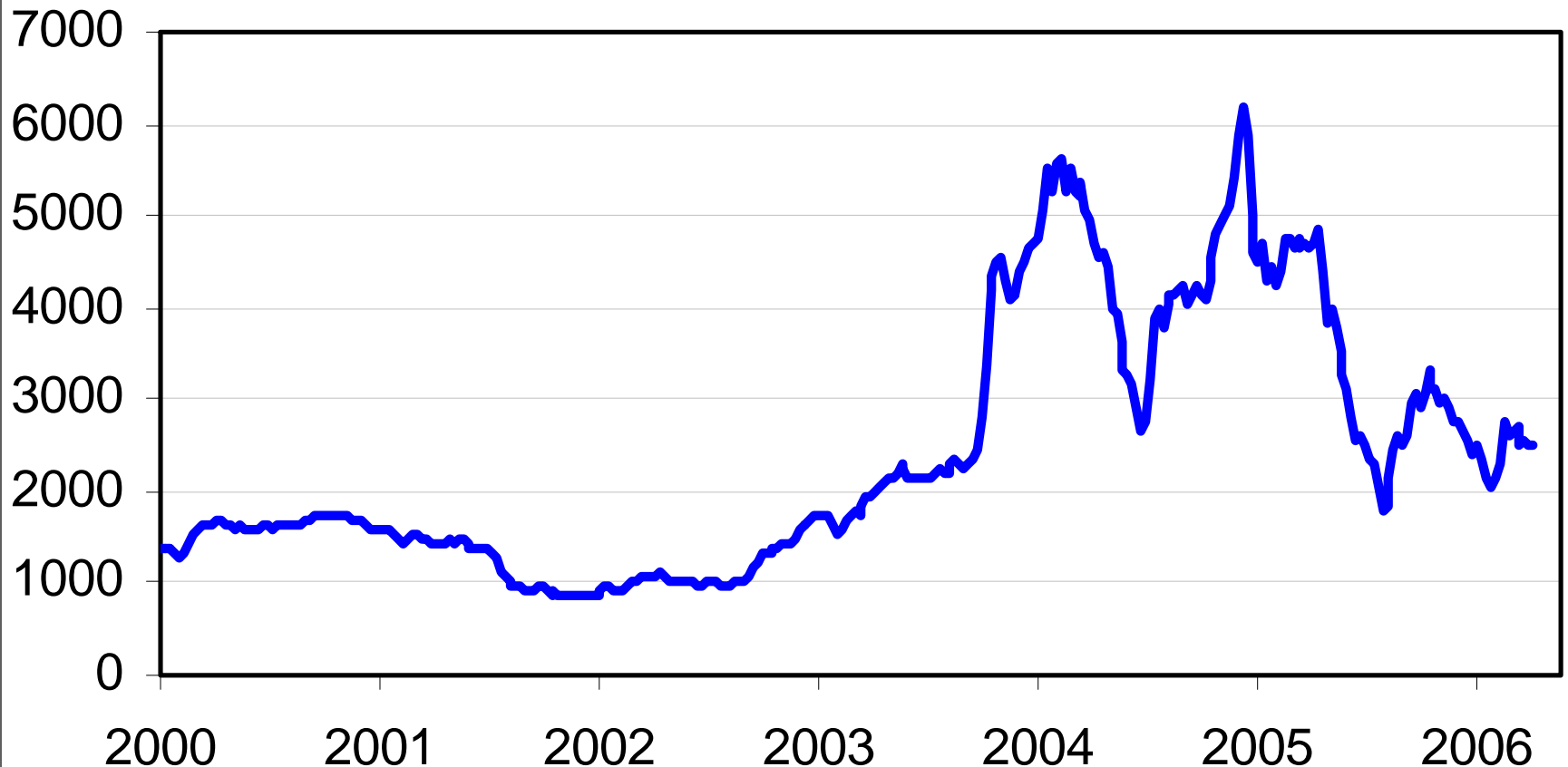
Percent change year ago



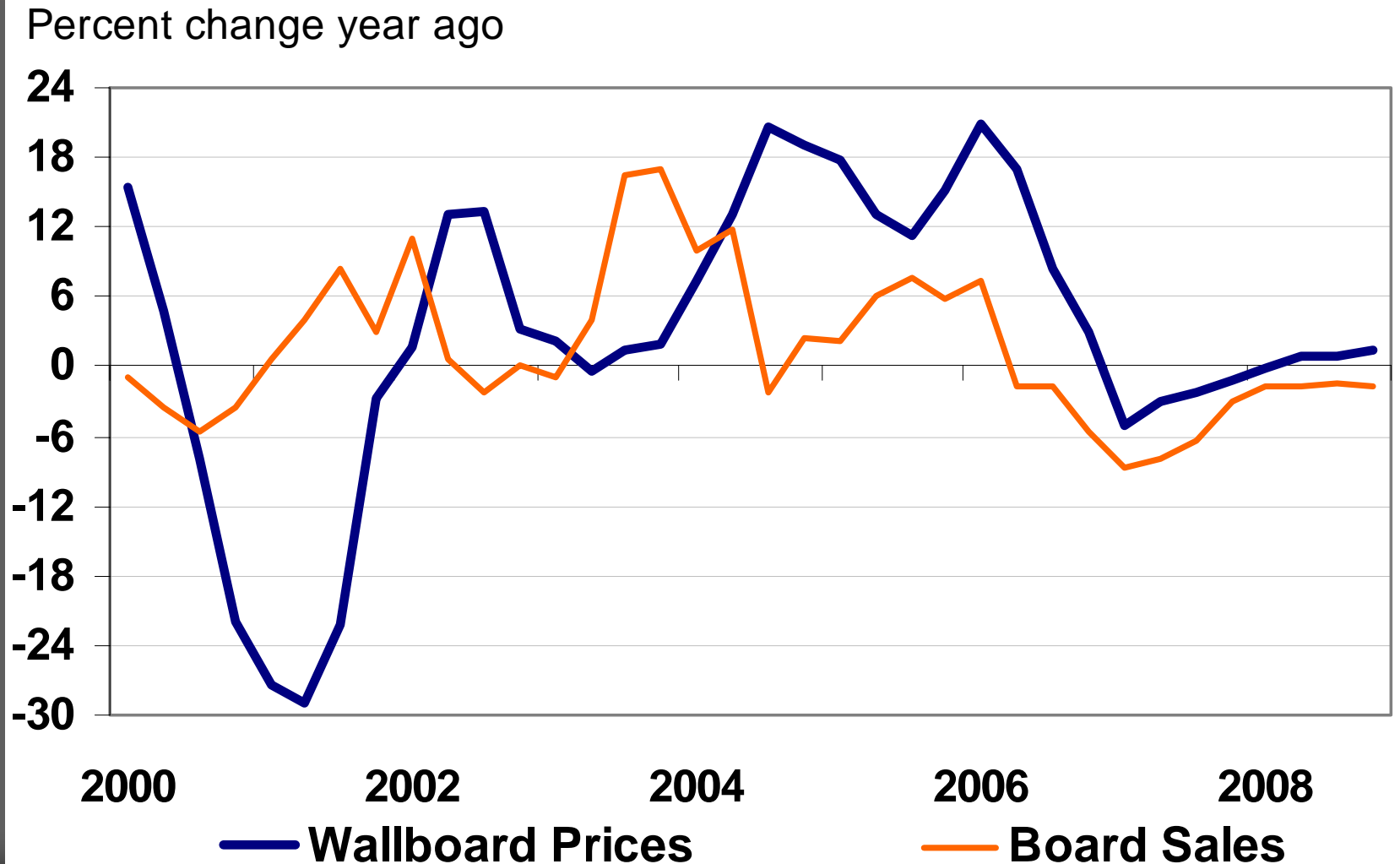
Ocean Going Shipping Rates Will Remain Soft

Shipping Rates

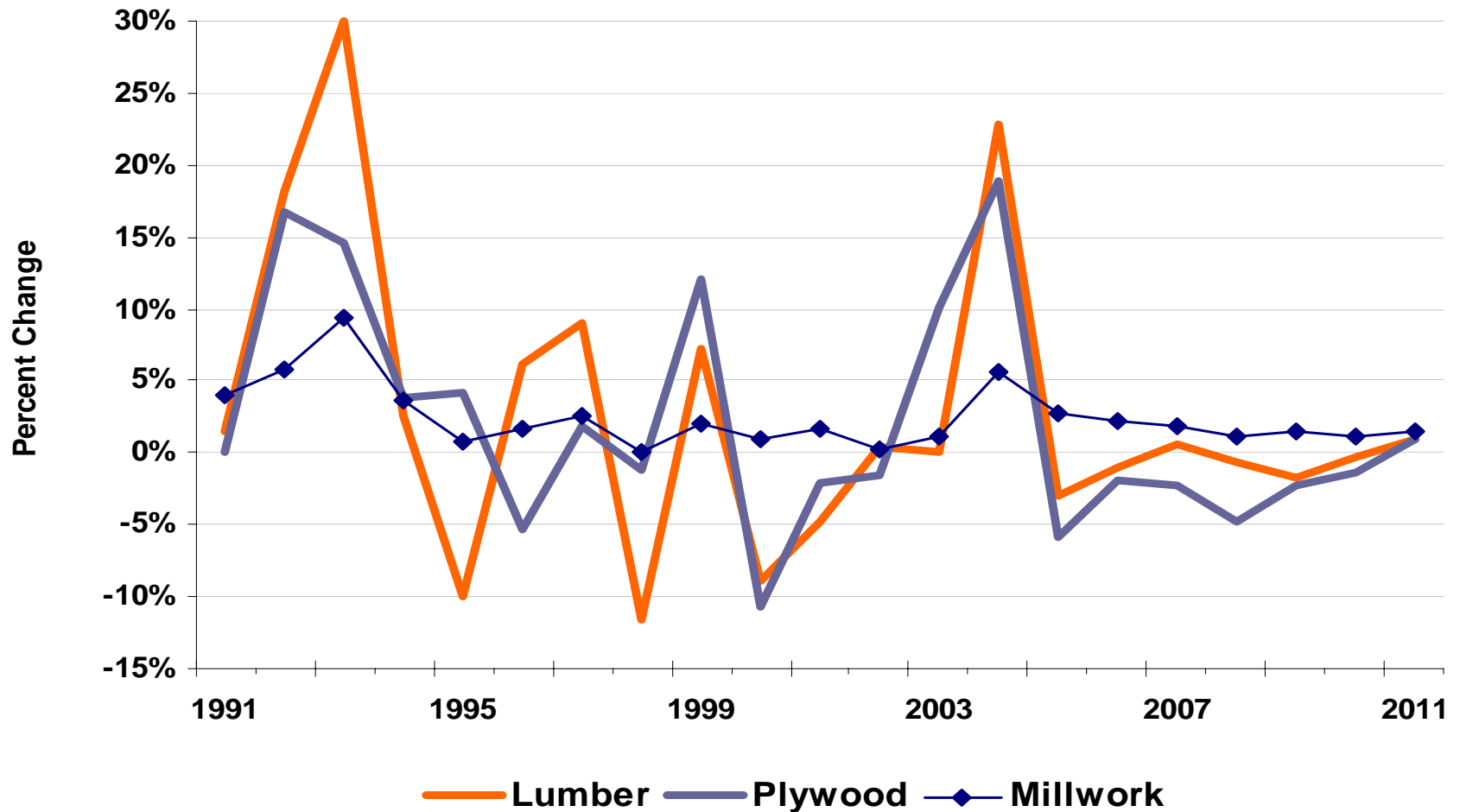
(Baltic Dry Index, Jan 1985=1000)



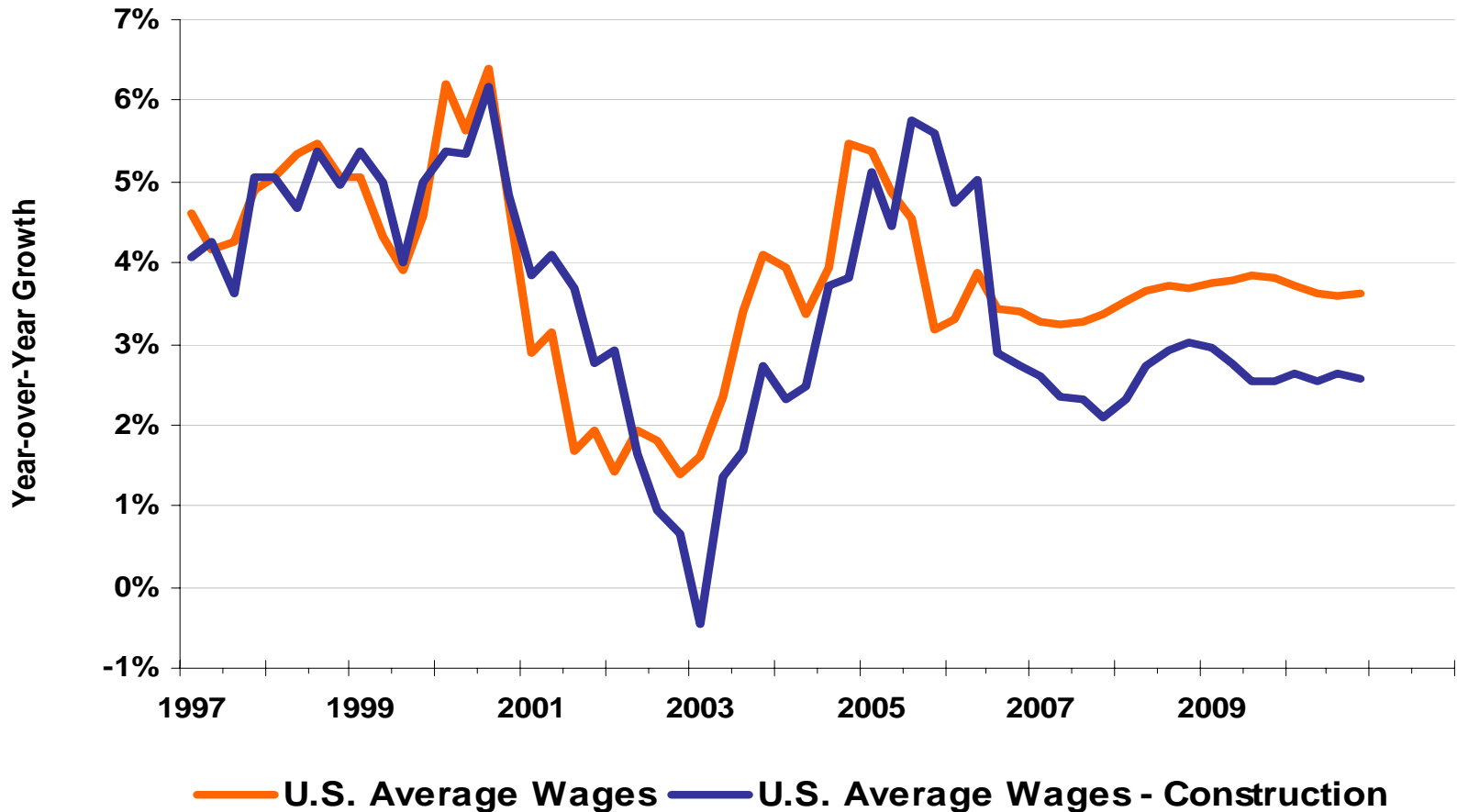
A Correction in Wallboard Prices is on the Way



Lumber Prices will Fall with Reduced Demand



Construction Labor Cost Growth is Declining





Technology

John Hardy
President / CEO
The John Hardy Group

Technology

All things being equal, the functionality per system is increasing with 5 - 10% less cost. However, due to the increasing complexity of operations with internet distribution, timeshare, fractional and residential mixed-use components requiring integration, the overall net result is that this category is flat to up 10% depending on the facility.



OS&E

John Hardy
President / CEO
The John Hardy Group

OS&E

All things being equal, the exact list of OS&E from three years ago is down 5%. No significant changes are forecast going forward.



Pre-Opening

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President / CEO
The John Hardy Group

Pre-Opening

Depending on the facility, the cost changes are flat to going up slightly. The higher the quality level or the more design unique the facility, the more costs will increase.



Contingencies

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The John Hardy Group

Contingencies

Renovations:	10 – 20% depending on speed and condition of facility
Redevelopment:	15 – 25% depending on speed, extent of scope, and location of facility (union / access)
New Development:	10 – 15% depending on speed, extent of scope, complexity of project, and location (union / access / winter conditions)

The image features a landscape background. The top portion shows a sky with soft, light-colored clouds. Below the sky is a thin, bright yellow horizontal band, likely representing a sunset or sunrise. The bottom two-thirds of the image are a solid, dark grey color. Centered in the grey area is the word "Recommendations" in a bold, red, sans-serif font.

Recommendations

Recommendations

Assumes no major positive or negative shocks to the system:

- ***GO BACK TO THE FUNDAMENTALS!***
- Expedite the start of the deal-don't use all the "float" up front.
- Slow down the implementation
- Add a market research component to your cost planning.
- "Fast Track" projects will face increased cost exposure.
- Compromise your scope for pricing flexibility.
- Retain "qualified" consultants
- Pay fair fees, don't fall for low fees
- Build development teams with continuity in mind
- Be realistic about scope, budget and schedule.
- Share the "real" budget
- No design presentations without line item budgets
- Promote teamwork
- Make timely decisions
- Commit as early as possible for procurement and aggregate buying
- Conduct pricing updates as frequently as possible
- Utilize GCs & Subs outside of overheated markets

Conclusion

Higher development costs are here to stay. Don't make it any more expensive by creating additional opportunities for cost escalation due to working against the present cost environment.