THE JOHN HARDY GROUP

Hotel Development Costs Survey

December 09

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Summary

The first decade of the 21st century has been a turbulent time for the U. S. economy. The early part of the decade suffered from the lingering effects of the tech bubble and the impact of the terrorist attacks of September 11, 2001. Mid-decade was a period of strong economic growth and escalation in material prices (such as oil and copper) fueled by consumer spending and real estate speculation. The collapse of the housing market in late 2007 began an economic decline unprecedented in the lives of most Americans. The design and construction industry has been particularly hard hit by these events.

The John Hardy Group has undertaken a study to determine the impact of the recent economy on hotel development. We wanted to find the answers to three questions: Where have we been? Where are we now? And, what does the near-term future look like? We researched all facets of hotel development including construction, FF&E, operations and consulting. Some information, such as overall construction costs and spending, was readily available while other data was anecdotal at best or non-existent. We also reached out to JHG's database of contractors, vendors, operators and consultants to gauge the pulse of the industry.

To understand the construction market we reviewed data complied by several sources including the Association of General Contractors, Reed Construction Data and the Bureau of Labor Statistics. The American Institute of Architects yielded information on overall billings of architectural services. No significant data on hotel FF&E and operations cost trends was found so we relied on feedback from vendors, purchasing agents and hotel operators to obtain an understanding of these sections of the market.

Over the past decade, fueled by worldwide demand for construction materials, construction costs have increased at approximately twice the rate of inflation. This trend has quickly reversed itself over the past two years and costs have fallen to 2006 levels. Similarly, the decline in construction activity and increased competition has lowered costs for consulting fees and hotel FF&E. General economic signals indicate the economy is bottoming out and early signs of recovery are evident. However, the recovery is expected to be sluggish and, except for construction materials, there is little near-term upward pressure on the major components of hotel development, redevelopment and renovation through 2010. Tight credit is stifling the market but to investors, developers and operators with access to capital the coming year offers an unprecedented opportunity to take advantage of the hotel development market at a discount.

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Hotel Development Cost Forecast
general economic trends

- China's economy is recovering, which is putting pressure on prices of construction materials.
- GDP in the US is slowly improving indicating that economic recovery has started.
- Overall sluggish growth is expected in the US over the next 1 to 3 years.
- Unemployment in the US is expected to remain high.
- The consensus within the design and construction community is that tight credit is the single biggest factor impacting the recovery of non-residential building construction.

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Hotel Development Cost Forecast
construction trends

- After a three-year decline housing starts and expenditures are increasing.
- Non-residential construction is expected to recover in mid-2010; however, the recovery is expected to be sluggish.
- Construction materials costs are expected to rise significantly above the inflation rate through 2011.
- Little new full service hotel construction is expected over the near term; most hotel construction will be redevelopment or renovation projects.

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Hotel Development Cost Breakdowns

- Due to slow recovery of the hotel industry, little new construction of full service hotels is expected in the next 3 or more years.

- Once banks release toxic assets redevelopment opportunities will increase.

- Postponed hotel capital improvements are creating pent up demand for renovation.

- For redevelopment and renovation, construction and FF&E are by far the largest expenditures for capital improvements.

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Hotel Development Cost Forecast

- For hotel redevelopment and renovation the biggest cost factors (totaling 80% or more) are construction and FF&E.
- Due to the economic recovery in Asia and rebound in the US housing market, construction material prices have bottomed out and there is significant upward pressure on prices to as much as 8% in 2010 and beyond.
- Sluggish growth of the US economy, lack of employment growth and slow recovery of non-residential construction will keep downward pressure on construction costs exclusive of materials.
- FF&E costs are down with little apparent pressure for cost increases over the next year or more until the US economy recovers.
- Consultant costs are likely to remain competitive in 2010.
- With planning for hotel renovation and/or redevelopment requiring 6 to 9 months time prior to construction there is a window of opportunity over the next six months to take advantage of lower costs for construction and FF&E before stronger growth occurs as expected in 2011.

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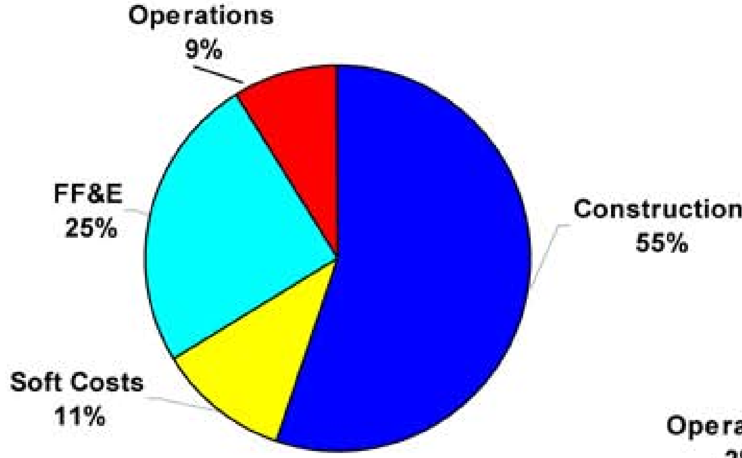
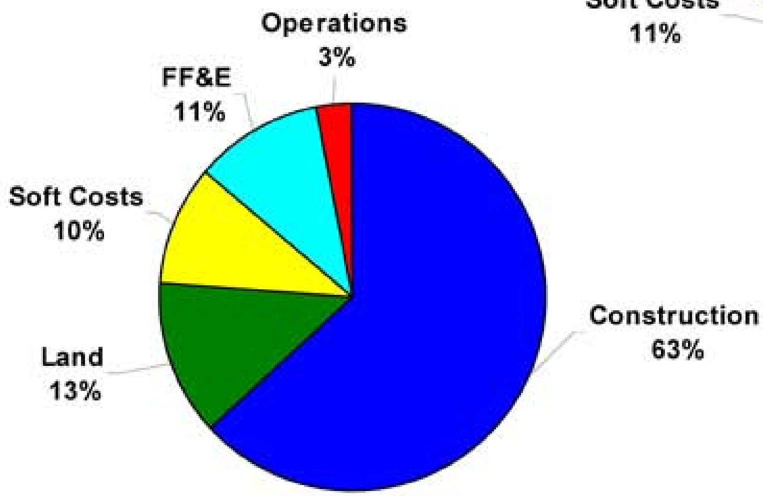
Development Cost Percentage Breakdowns

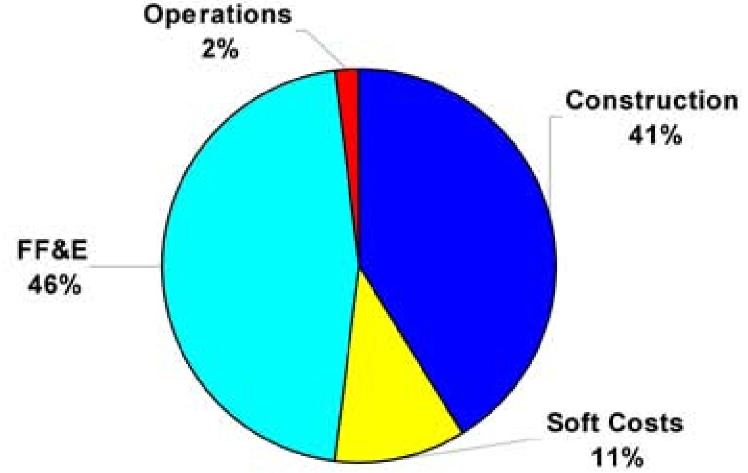
Redevelopment



New Construction



Renovation



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Consultant Survey
summary

JHG issued a survey to consultants, contractors, vendors and hotel operators across the country regarding current economic conditions; their responses are as follows:

- 75% of consultants indicated that their revenues have been impacted significantly by the economy.
- Half of these consultants expect fees to remain at current levels in 2010; one third expect them to increase slightly to moderately.
- Overwhelmingly (77%) consultants see loosening of credit markets as the single most important economic factor that would boost work loads and revenues.
- 45% of consultants see continued high unemployment as the biggest potential drag on the design / construction industry; 20% are concerned with high government taxes and spending.

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Consulting Costs

- Project inquiries at architecture firms are positive although new projects are lagging behind.
- Slight upward trend in AIA architectural billings index indicates that work loads appear to be bottoming out.
- Strong competition for work remains.
- Little significant upward pressure on architectural fees is evident.
- Therefore consulting fees are likely to remain steady through 2010.

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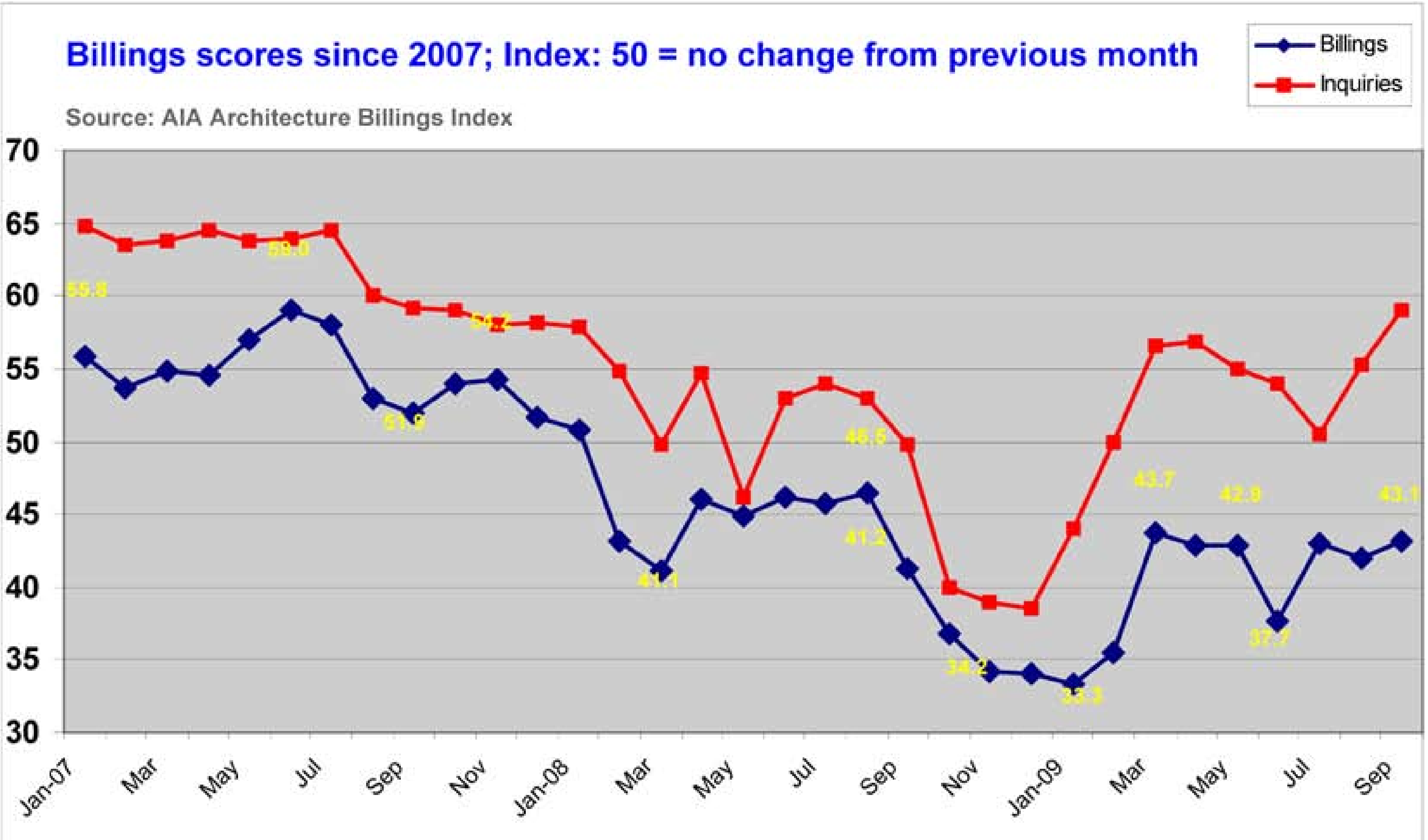
Architecture Billings Index

Appears to be in a Holding Pattern
Inquiries Continue to be Positive, but are Not Producing New Workloads



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Contractor Survey
summary

- In response to current economic conditions many contractors have reduced staff and/or salaries, reduced profit margins and pursued new markets.
- 80% reported that overall construction costs have decreased (some as much as 20%) over the past 12 to 18 months.
- 60% believe construction costs will decline further; 40% believe they will remain unchanged or increase slightly.
- Approximately half of the respondents see the credit markets as the most significant economic influence on construction; one quarter indicated that recovery of the housing markets was the key factor.
- Similarly, about half of the contractors were concerned with high government taxes and spending having a negative effect on construction; a quarter were concerned with government intervention in the economy.

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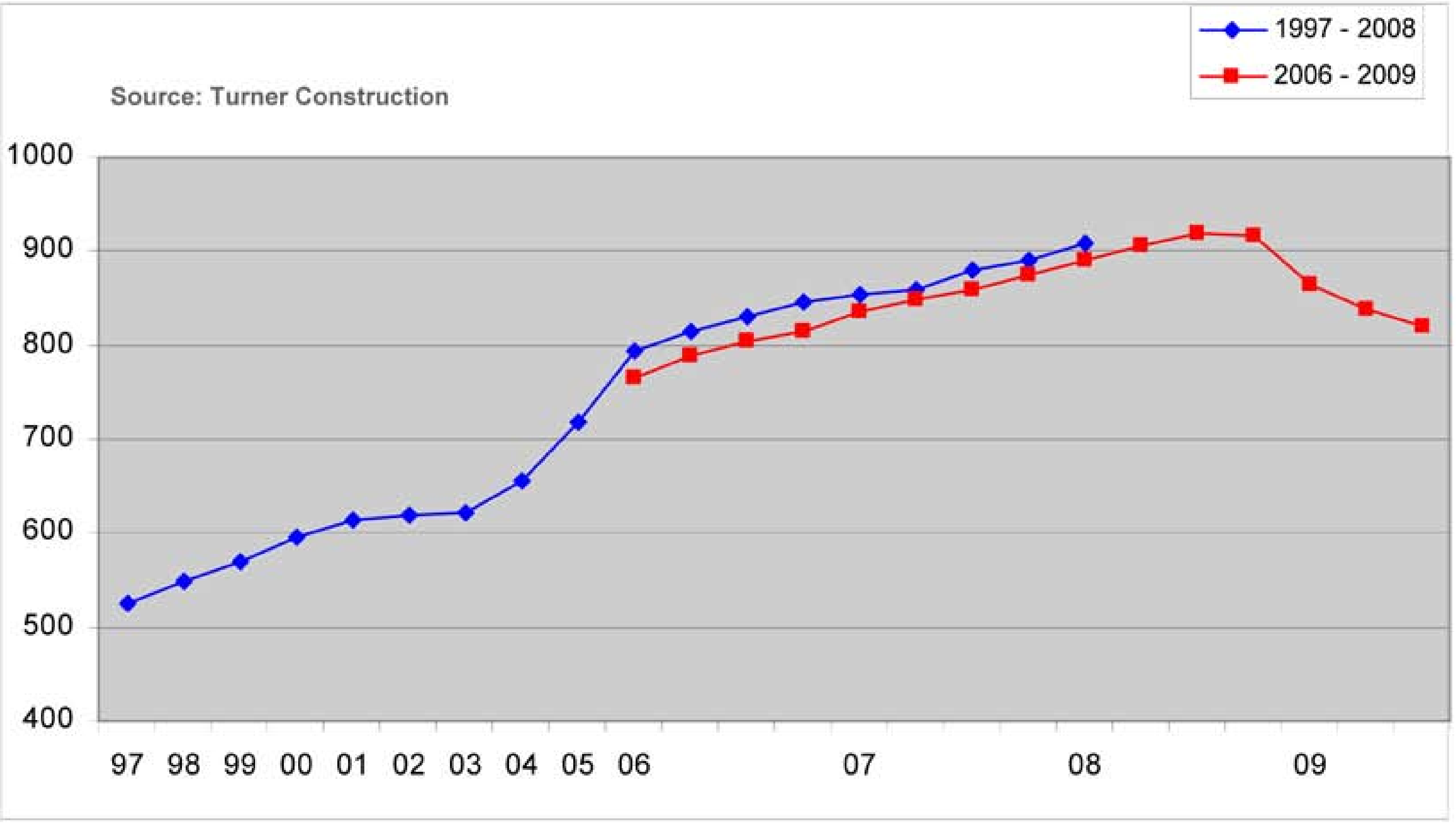
Construction Costs

- Construction costs have declined approximately 11% from the peak in 2008 down to 2006 levels, the first decline in over 12 years.
- Overall material prices have declined more than 8% but appear to have bottomed out.
- Some materials (copper, aluminum, steel, diesel fuel) are increasing.
- Non-residential construction spending is projected to decline until mid-2010.
- Residential construction appears to have bottomed out and is beginning to rise.
- Due to global economic recovery, construction material prices are expected to rise 4% to 8% in 2010.
- Rebound in housing will put upward pressure on lumber, gypsum and other typical renovation material prices.
- Sluggish growth in the US construction market will keep competition for projects tight and margins low.

Turner Building Cost Index

1997 – 2001 4.2%/Year
2001 – 2004 0.7%/Year
2003 – 2008 9.2%/Year
Q4 2008 – Q3 2009 10.8%



PPI Index for Construction

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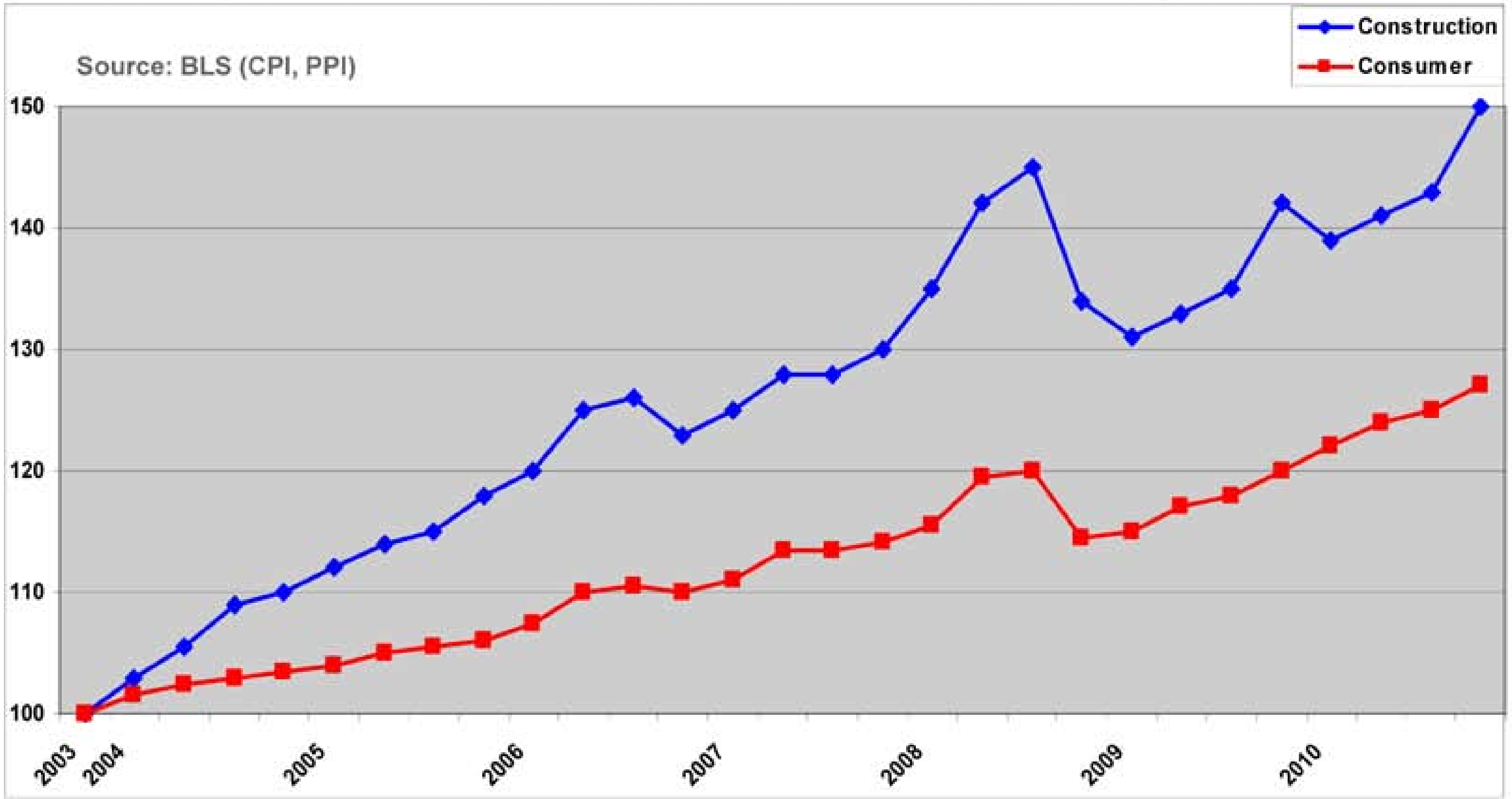
Producer price index (PPI) for construction vs. consumer price index, 2003 – 2009.
Estimating a 6% increase in 2010.

PPI for inputs to construction industries: 33% **Consumer price index: 17%**



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FF&E Procurement & Vendor Survey

- Although there were a variety of opinions on typical hotel FF&E costs from purchasing agents, it appears that the cost of FF&E for a typical 3 to 4 star guestroom has decreased 8 – 10% for materials and freight.
- 75% of vendors responding have seen moderate to significant decreases in revenues.
- Half of the vendors see stagnant or declining revenues in 2010; the other half project increased revenues.
- 65% of vendors have reduced prices up to 5%; 35% have decreased prices by up to 15%.
- 90% of vendors see the prices of their products remaining steady throughout 2010.
- 77% believe loosening of the credit markets will have the most positive impact on improving sales.
- 35% are concerned that high unemployment will hurt the economy while another 30% are concerned about government taxes and spending.

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FF&E and Operating Costs

- There is a wide variance in the impact of the economy on hotel FF&E prices depending on the type of product and the source; however, FF&E costs for a typical 3- to 4-star hotel room have dropped an estimated 8% to 10%.
- Purchasing agents and vendors generally expect FF&E prices to hold steady throughout 2010.
- The recovery of the US economy is seen as the primary factor impacting hotel FF&E costs.
- Operations costs are expected to remain steady through 2010; these costs are generally minor on redevelopment and renovation projects.

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Operator Survey
summary

- 70% of operators have seen a decline in pre-opening expenses and OS&E costs.
- 57% report no change in IT systems costs; 43% have experienced a slight decrease.
- All operators projected that pre-opening and FF&E costs were expected to remain the same over the next 12 months.
- 55% of operators see loosening of the credit markets as the single most important factor impacting hotel renovation work.
- Operators were split with 30% each believing high government taxes and spending and sharp increases in energy costs as the biggest potential negative economic factors.

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