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MIDDLE EAST HOTEL DEVELOPMENT COST TRENDS

Yasin Munshi
Consultant and Valuation Analyst

Hala Matar Choufany, MRICS
Regional Managing Director



www.hvs.com

HVS | Liberty House Building, DIFC, 7th Floor, Office 715, Dubai, UAE

Introduction

The HVS Middle East Hotel Development Cost Trends answers the industry's need for a comprehensive regional benchmark report that focuses solely on hotel development costs. For the purpose of this publication, HVS has tracked, analysed and compiled hotel development costs in key Middle Eastern markets since 2010. Each year, HVS Consulting & Valuation researches development costs from our database of actual hotel construction budgets, industry reports, and cost benchmarks per brand provided by hotel management companies. These sources provide the basis for our range of elemental costs per room. The markets presented in this report are the UAE, Saudi Arabia (KSA), Qatar, Bahrain, and Oman.

This study reports per-room hotel development costs and considers data for the following hotel classifications:

- Luxury;
- Upper-Upscale;
- Upscale;
- Midscale;
- Upscale Serviced Apartments.

We note the exclusion of Budget hotels from this publication due to the limited data available to draw sound conclusions on development costs for this classification of hotels. As the number of Budget hotels in the region is likely to increase, this will provide a larger sample set of data and we expect to include this classification in future publications.

In the HVS Middle East Hotel Development Cost Trends, the elements of a hotel development budget are broken down into five general categories: Land; Construction Costs and Site Improvements; Soft Costs; Furniture, Fixtures, and Equipment (FF&E) and Operating Supplies and Equipment (OS&E); and Pre-opening and Marketing. These categories provide general ranges for analysing and compiling hotel development budgets on a per-room basis. The classifications are broad enough for professionals with different areas of expertise to work with and understand.

The development costs of the same hotel classification can vary substantially between two locations in the same market. This is because development cost budgets are heavily influenced by building design, spatial planning, site conditions, project delays, as well as the individual aspirations of the owner/developer

This publication reflects average development costs per hotel classification in each market over a three year period between 2010 and 2013. The data represent a wide array of geographical locations within each market. The development costs of the same hotel classification, for example an upscale hotel, can vary substantially between two different locations in the same market. This is because development cost budgets are heavily influenced by building design, spatial planning, site conditions, project delays, as well as the individual aspirations of the owner/developer. Market conditions between 2010 and 2013 also changed, which impacted the prices of building materials and prices being charged by contractors.

Trends in Hotel Supply

The growth in hotel room supply illustrates the level of construction activity in a market, considering that the vast majority of hotels in the Middle East are new builds and that conversions of existing properties are rare. The change in supply also takes into account expansions and contractions of existing inventory. In more mature hotel markets, older and functionally obsolete properties are removed from inventory. We note however that the markets covered in this study are relatively nascent in terms of the average age of their branded hotel supply, and therefore the amount of removed inventory is negligible for the purpose of the ensuing analysis.

As illustrated in Figure 1, the UAE, Saudi Arabia, Qatar, Bahrain, and Oman have all experienced double digit growth percentages in branded supply between 2010 and 2013. Supply growth in the UAE remained the highest with approximately 14,300 rooms that were completed despite the challenging economic climate that slowed construction activity during the initial part of that period. Qatar saw the highest percentage growth in rooms supply of 89% as the country embarked on a rapid expansion, partly due to its preparation for the 2022 FIFA World Cup.

The total pipeline of branded hotel rooms scheduled to open between 2014 and 2018 would increase the total inventory by 57% across all markets. Saudi Arabia is expected to see the highest increase in supply of almost 26,900 rooms across its primary and secondary cities, with sizeable plans especially in Makkah. The UAE will receive approximately 21,800 rooms, half of which will be in Dubai. Construction activity in Dubai received a jolt in 2013 after the city won the bid to host the Expo 2020, which revived a number of hotel projects that had previously been on hold. Qatar will continue to strengthen its efforts to meet its commitments for 2022 as Doha is scheduled to receive approximately 7,000 additional rooms. Both Oman and Bahrain are expected to witness robust growth with the majority of proposed supply focused in Muscat and Manama respectively. We note that the total branded hotel supply expected to open by 2018 is subject to change due to delays in construction and hotel management companies signing additional deals to expand their presence in the region.

Strong economic and tourism growth outlooks, coupled with relatively abundant land availability, are the primary drivers for new hotel development in these markets. The large pools of high net-worth equity investors in this region (private or institutional) with strong balance sheets are gaining easier access to debt at comparatively low rates. Banks are expected to gradually increase their overall level of lending too and a growth in construction financing is therefore expected in order to support and facilitate the expansions in hotel supply. The persisting political turmoil across many Middle Eastern countries continues to benefit the more stable economies, such as the markets presented in this study, which will attract more regional foreign direct investment, notably in real estate. Opportunities for new-build projects remain ripe across all five markets, especially in secondary cities and B-grade locations within primary cities suitable for midmarket hotels.

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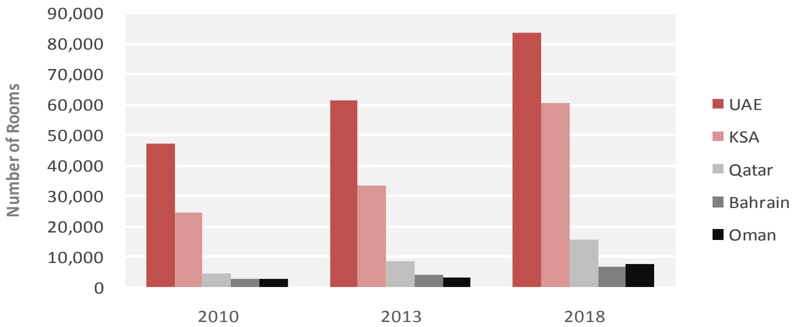
FIGURE 1: CHANGES IN BRANDED HOTEL SUPPLY PER MARKET BETWEEN 2010 AND 2018

Country	Branded Rooms Supply in 2010	Branded Rooms Supply in 2013	% Change 2010-13	Branded Rooms Supply in 2018	% Change 2013-18
UAE	47,000	61,300	30%	83,156	36%
KSA	24,300	33,200	37%	60,084	81%
Qatar	4,500	8,500	89%	15,441	82%
Bahrain	2,600	4,200	62%	6,721	60%
Oman	2,500	3,233	29%	7,522	133%
Total	80,900	110,433	37%	172,924	57%



Source: HVS; Smith Travel Research

Figure 2 provides a breakdown of proposed hotel room supply between 2014 and 2018 by hotel classification for the benefit of the reader. Looking at the total of the five markets below, we notice that almost half of the new supply will be Upper-Upscale and Upscale hotels, while the smallest percentage will consist of Budget hotels.

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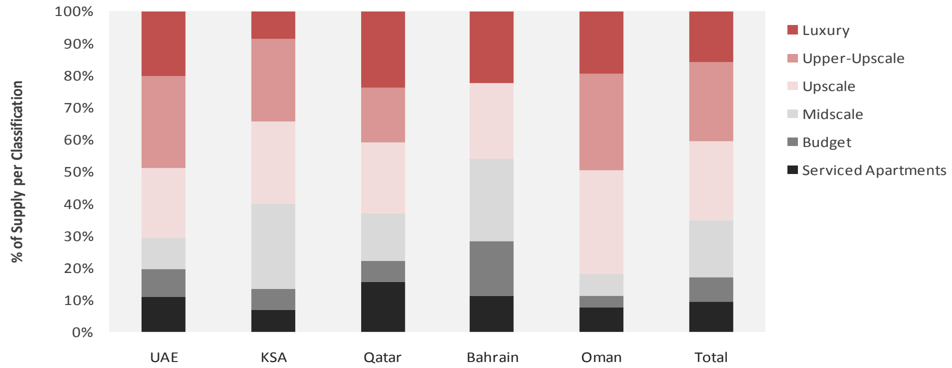
FIGURE 2: NUMBER OF PROPOSED ROOMS BY HOTEL CLASSIFICATION (2014-2018)

	UAE		KSA		Qatar		Bahrain		Oman		Total	
Luxury	4,425	20%	2,358	9%	1,670	24%	563	22%	846	20%	9,862	16%
Upper-Upscale	6,229	29%	6,876	26%	1,170	17%	0	0%	1,278	30%	15,553	25%
Upscale	4,771	22%	6,952	26%	1,534	22%	601	24%	1,384	32%	15,242	24%
Midscale	2,157	10%	7,096	26%	1,025	15%	647	26%	292	7%	11,217	18%
Budget	1,871	9%	1,726	6%	471	7%	423	17%	155	4%	4,646	7%
Serviced Apartments	2,403	11%	1,876	7%	1,071	15%	287	11%	334	8%	5,971	10%
Total	**21,856**		**26,884**		**6,941**		**2,521**		**4,289**		**62,491**	



Source: HVS

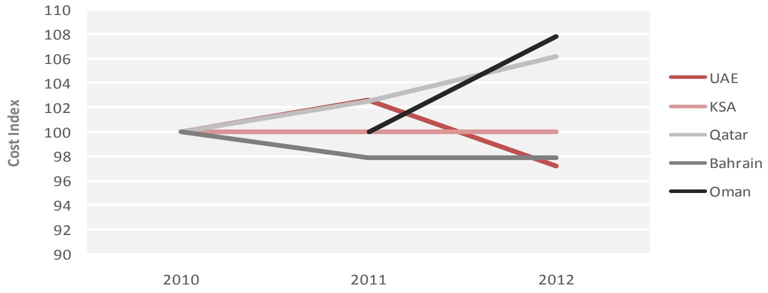
Trends in Construction Costs

We provide in the following paragraphs an analysis of building material costs. The principal building materials used in construction include cement, concrete, sand, steel, wood, plastic and fuel, and their prices vary upon the amount of supply and demand in the market. Building material costs are therefore tied to the amount of construction activity in a market and further beyond. Construction activity also includes sectors outside of real estate such as transport, power, and other infrastructure. Markets that are experiencing construction booms across multiple sectors are more likely to encounter shortages in supply of materials, which would drive material input prices upwards. In addition to the shift in costs is the increasingly global sourcing of materials, where transportation costs and currency exchange rates play an important role. Supply and demand influences are magnified by the challenges of procuring materials due to changes in global availability, pricing, quality, and delivery.

Figure 3 overleaf, illustrates a cost index of the main building materials used in construction which includes cement, concrete, sand, steel, wood, plastic, and fuel. Through our research and use of existing benchmark reports, we have compiled costs for these various items in all five markets over a three year period. The building material costs have been indexed to base values in 2010.

FIGURE 3: BUILDING MATERIALS COST INDEX 2010 - 2012

Country	2010	2011	2012
UAE	100	103	97
KSA	100	100	100
Qatar	100	102	106
Bahrain	100	98	98
Oman	n/a	100	108



Source: HVS

Hotel developers need to consider the trends in building material costs and their likely impact on development budgets in the future. Material costs directly influence Construction/Hard Costs which account for 69-76% of the overall development budget, depending on the hotel classification

The UAE saw a sharp drop in building material costs in 2012 as a result of fewer projects being awarded in 2011, which caused a construction slowdown and less demand for materials. With the construction sector having re-gained its momentum in 2013, the UAE is expected to spend over US$300 billion by 2030, which is the highest amount in any GCC country. As the country will witness further growth in real estate, with many ambitious projects and overall infrastructure development to accommodate the Expo 2020, we expect an upwards trend in material costs in the short term.

A great deal of construction planning took place in Saudi Arabia between 2010 and 2012, with record-high numbers of projects being awarded. However, delays in the execution of many of these projects caused material costs to remain relatively stable. Large public spending commitments from the government to invest in transport infrastructure, expanding the capacities of their holy cities, and further developing residential real estate will boost construction activity in the short term. With total construction expenditures projected to exceed US$200 billion by 2030, the increased demand for building materials is likely to exert upwards pressure on costs.

Qatar was witnessing a full construction boom between 2010 and 2012, with the face of its capital Doha rapidly changing. Sharp economic and demographic growth has spurred high levels of activity in all construction sectors. This in turn has already influenced material costs, which are currently the highest in the GCC. As the construction boom continues and the country races to prepare for the FIFA 2022 World Cup and beyond, construction expenditures are estimated to exceed US$150 billion by 2030. Qatar is likely to encounter shortages in building materials due to the heightened demand, which will exert further pressure on costs.

Bahrain was historically the most expensive country in the GCC for construction materials before it was overtaken by Qatar. Bahrain witnessed a slight drop in material costs in 2011, mainly in cement and concrete. With political uncertainty still in the picture, and a weaker economic outlook compared to its GCC neighbours, Bahrain is expected to struggle to compete in attracting investment. The country is supposed to receive infrastructure grants from its GCC neighbours, which is likely to increase demand for materials. Costs in Bahrain are expected to remain high as the country relies almost entirely on imports of construction materials.

Data on Oman was not available for 2010. The country witnessed a rise in material costs in 2012 with a healthy construction industry underpinned by public and private investment. Its ambitious transport infrastructure plans, growth in oil and gas projects, and a strong focus on tourism development will provide sustained levels of demand for construction materials.

In summary, construction activity across all sectors in the GCC is rising which is likely to cause a demand and supply imbalance in building materials, leading to an increase in prices in the short term. **Hotel developers in the above markets need to consider these trends in building material costs and their likely impact on development budgets in the future. Material costs directly influence Construction/Hard Costs which account for 69-76% of the overall development budget, depending on the hotel category.** As a hedging strategy against the anticipated price increases, hotel developers can consider locking into forward contracts on material prices to control budget overruns.

Other key factors to consider are the increasing labour costs in the region, which are causing contractors to downscale and adopt more technologically advanced systems that require higher capital infusions but have cost benefits in the long term. An increasing move towards "Green" designs is also likely to increase the demand for new materials, the use of renewable energy sources like photovoltaics, and other energy-saving systems. The UAE is already slowly introducing regulations for minimum standards on new buildings in line with the Estidama program. Hotel operators are incorporating more environmentally-friendly aspects into their brand standards to meet guest requirements and more importantly as part of their CSR initiatives. A gradual push from regulators and end-users towards more environmentally-friendly buildings will affect construction costs. While "Green" constructions usually cost more, the buildings benefit from lower operating costs, and the use of more durable materials tends to improve asset lifecycles.

Hotel Development Cost Categories

For the purpose of this publication, HVS has developed the following summary format for development budgets which forms the basis for our cost categories. We find these categories are meaningful for hotel professionals when undertaking analysis relating to hotel feasibility. While our structure is not an accounting practice, it does provide a basis to analyse proposed projects.

Land has purposely been excluded from this analysis as land costs in the Middle East vary greatly depending on location. Removing land cost also allows for a fair comparison of development costs irrespective of freehold or leasehold land tenures.

FIGURE 4: HVS HOTEL DEVELOPMENT COST CATEGORIES

Land - *Not included in this study*
Hard Construction and Site Improvements
Building Costs
Contractor Overhead
Site Improvements
Landscaping Costs
Parking
Subcontractor's Bids
Engineering Costs
Building and Monument Signage
Construction Contingency
Soft Costs
Financing Costs
Architectural/Design Fees
Interior Design Fees
Other Professional Fees (Legal, Consultants, etc)
Fixtures Furniture and Equipment (FF&E) and Operating Supplies and Equipment (OS&E)
Guestroom Furniture and Fixtures
Bathroom Furniture and Fixtures
Public Space and Meeting Room Furniture and Fixtures
Kitchen and Laundry Equipment
Softgoods including Carpets, Drapes and Rooms Accessories
Supply Inventories - Linen, Operating Supplies, Initial Purchases
Pre-opening and Marketing
Technical Services Fees
Pre-opening Recruitment, Staffing, Training
Operating Reserves
Marketing Expenses

Source: HVS; Hotel Development Cost Survey 2013/14 (HVS San Francisco)

Hotel Classification Assumptions

Our computation of development costs are based on our database of actual hotel construction budgets, industry reports, and cost benchmarks per brand provided by hotel management companies. The costs presented in this report are intended to reflect the development costs for **typical hotels** under each classification. Figure 5 illustrates the typical room inventories, room sizes, facilities, and approximate built-up areas for each hotel classification that forms the basis of our analysis. Changes in these parameters can have resulting differences in overall project costs to those presented in this publication.

FIGURE 5: HOTEL CLASSIFICATION ASSUMPTIONS

Hotel Classification	No. Keys	Standard Room Size (m^2)	No. F&B Outlets	Meeting Space (m^2)	Spa	Parking	Gross Area per Key (m^2)	Built-up Area (m^2)
Luxury	200	48	5	900	Yes	Single Basement	115	23,000
Upper-Upscale	250	40	5	1000	Yes	Single Basement	100	25,000
Upscale	280	32	3	500	No	Single Basement	80	22,400
Midscale	300	28	2	200	No	Single Basement	70	21,000
Upscale Serviced Apartments	220	45	1	0	No	Single Basement	80	17,600

Source: HVS Assumptions

Per-Key Hotel Development Costs

Figure 6 illustrates the average development costs per key for each hotel classification based on the typical design and facility mix presented in Figure 5. The costs reflect averages over the five markets covered in this study, which include the UAE, Saudi Arabia, Qatar, Bahrain and Oman.

FIGURE 6: DEVELOPMENT COSTS PER KEY (US$)

Hotel Classification	Hard Costs	FF&E and OS&E	Soft Costs	Pre-Opening and Marketing	Total per Key*	Total per m^2*
Luxury						
Cost per Key	317,400	87,400	46,000	9,200	**460,000**	**4,000**
% Allocation	*69%*	*19%*	*10%*	*2%*		
Upper-Upscale						
Cost per Key	224,400	59,400	39,600	6,600	**330,000**	**3,300**
% Allocation	*68%*	*18%*	*12%*	*2%*		
Upscale						
Cost per Key	159,600	36,500	27,400	4,500	**228,000**	**2,850**
% Allocation	*70%*	*16%*	*12%*	*2%*		
Midscale						
Cost per Key	121,800	19,700	19,700	3,300	**164,500**	**2,350**
% Allocation	*74%*	*12%*	*12%*	*2%*		
Upscale Serviced Apartments						
Cost per Key	152,000	26,000	18,000	4,000	**200,000**	**2,500**
% Allocation	*76%*	*13%*	*9%*	*2%*		

Source: HVS

** Cost per key and per m^2 based on room count and total built up areas presented in Figure 5*

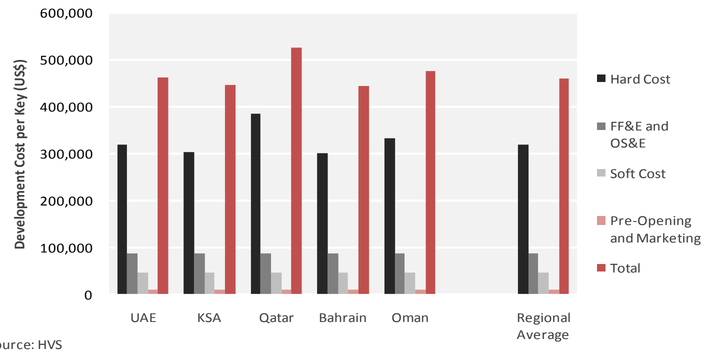
Per-Key Hotel Development Costs per Market

As discussed previously in this study, the differences in building material costs in each market have a significant impact on the Construction/Hard Costs of a development, which account for the largest portion of the overall development cost. Construction/Hard Costs therefore vary per market, which are the fundamental reasons for variances in overall development costs in different markets. Our experience in hotel feasibility studies and reviews of numerous development budgets indicate that the other cost categories such as FF&E and OS&E, Soft Costs, and Pre-opening and Marketing, are less influenced by geographic factors. They are usually more influenced by individual hotel brand standards, abilities to negotiate favourable procurement contracts, debt financing terms, variances in consultant fees, and the efficiency of the overall development process.

We have therefore applied the differences in building material costs per market to estimate how Hard/Construction Costs are likely to vary. We have kept other costs constant at regional average values. The results, illustrated in Figure 7 overleaf, therefore provide indicative total development costs per key for the five markets covered in this study. We have cross-checked these amounts with our database of actual development budgets in each of the five markets, as well as industry benchmarks on construction costs per square meter in different markets. We note again that our development estimates are meant to reflect **typical hotels** for each classification (please refer back to Figure 5).

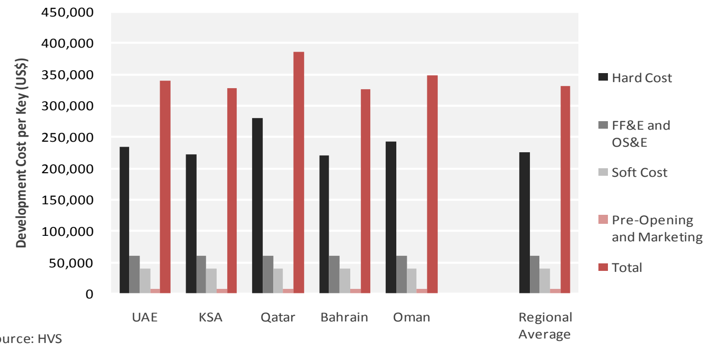
FIGURE 7: DEVELOPMENT COSTS PER KEY (US$)

Luxury	UAE	KSA	Qatar	Bahrain	Oman	Regional Average
Hard Cost	319,300	303,300	383,100	300,100	332,100	317,400
FF&E and OS&E	87,400	87,400	87,400	87,400	87,400	87,400
Soft Cost	46,000	46,000	46,000	46,000	46,000	46,000
Pre-Opening and Marketing	9,200	9,200	9,200	9,200	9,200	9,200
Total	**461,900**	**445,900**	**525,700**	**442,700**	**474,700**	**460,000**



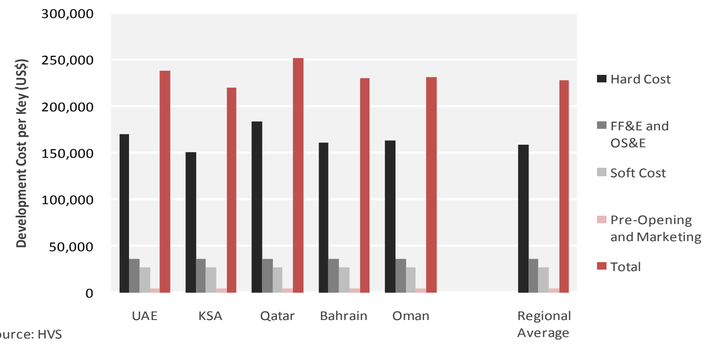
Source: HVS

Upper-upscale	UAE	KSA	Qatar	Bahrain	Oman	Regional Average
Hard Cost	233,200	221,500	279,800	219,200	242,500	224,400
FF&E and OS&E	59,400	59,400	59,400	59,400	59,400	59,400
Soft Cost	39,600	39,600	39,600	39,600	39,600	39,600
Pre-Opening and Marketing	6,600	6,600	6,600	6,600	6,600	6,600
Total	**338,800**	**327,100**	**385,400**	**324,800**	**348,100**	**330,000**



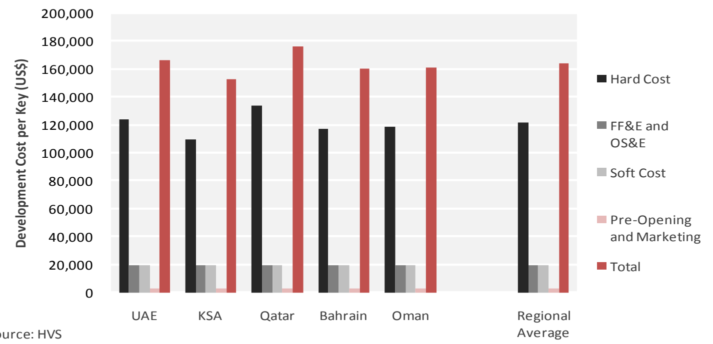
Source: HVS

Upscale	UAE	KSA	Qatar	Bahrain	Oman	Regional Average
Hard Cost	170,500	151,700	184,100	161,900	163,700	159,600
FF&E and OS&E	36,500	36,500	36,500	36,500	36,500	36,500
Soft Cost	27,400	27,400	27,400	27,400	27,400	27,400
Pre-Opening and Marketing	4,500	4,500	4,500	4,500	4,500	4,500
Total	**238,900**	**220,100**	**252,500**	**230,300**	**232,100**	**228,000**



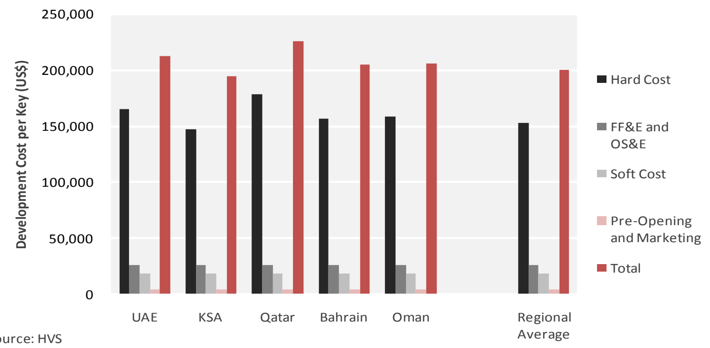
Source: HVS

Midscale	UAE	KSA	Qatar	Bahrain	Oman	Regional Average
Hard Cost	123,900	110,200	133,800	117,700	118,900	121,800
FF&E and OS&E	19,700	19,700	19,700	19,700	19,700	19,700
Soft Cost	19,700	19,700	19,700	19,700	19,700	19,700
Pre-Opening and Marketing	3,300	3,300	3,300	3,300	3,300	3,300
Total	**166,600**	**152,900**	**176,500**	**160,400**	**161,600**	**164,500**



Source: HVS

Upscale Serviced Apartments	UAE	KSA	Qatar	Bahrain	Oman	Regional Average
Hard Cost	164,500	146,400	177,600	156,200	157,900	152,000
FF&E and OS&E	26,000	26,000	26,000	26,000	26,000	26,000
Soft Cost	18,000	18,000	18,000	18,000	18,000	18,000
Pre-Opening and Marketing	4,000	4,000	4,000	4,000	4,000	4,000
Total	**212,500**	**194,400**	**225,600**	**204,200**	**205,900**	**200,000**



Source: HVS

Conclusion

This publication provides indicative hotel development costs per market based on differences in material and construction costs between markets. These estimates assume "typical" hotel designs under each hotel classification. Properties that are designed with numerous food and beverage outlets, extensive meeting and banqueting space, extensive wellness or other facilities with unusual dimensions will immediately be subject to higher development costs than the amounts featured in this publication. Determining the appropriate mix of facilities and their built-up areas must be done through a detailed study of a hotel market to understand the demand potential that will justify the level of investment. Efficient building designs with careful space planning can maximise the ratio of revenue-generating area to total built-up area in a hotel and minimise the amount of wasted space, which will benefit the overall returns of a project.

There are other factors, unique to each hotel project, which will influence the development costs. The following list is not exhaustive but highlights some of the most relevant factors in this region:

- Owner aspirations and personal reasons for developing a hotel are not always entirely motivated by financial returns. These types of investments, which are known to be more common in this region, will typically see hotel projects being developed at much higher budgets than the norm;

- Site conditions - Certain sites in remote locations will require the installation of their own water treatment facilities and power grids to support a hotel development. Sometimes accessibility to the site can be a challenge, which is likely to require additional road construction. The general topography can pose design challenges while soil conditions will dictate the level of depth and method needed to lay the building foundations;

- Hotels that form part of mixed-use developments can benefit from shared facilities where costs are divided between different components of the development;

- Resort developments are typically built at lower densities over larger surface areas, hence requiring higher landscaping costs. Room sizes are usually larger, and the properties will offer a wider variety of facilities;

- Procurement strategies are different methods of realising a construction project. Developers can choose to differ from the traditional approach of appointing the designer and contractor separately. The Design-build method for example, appoints a single entity for the design and contracting, which can shorten delivery timelines and reduce costs, while also reducing the development risk;

- Changes in regulatory requirements for hotels to qualify for different classifications, such as minimum room sizes and number of food and beverage outlets, can increase development costs if the regulations stipulate larger facilities and higher standards.

We therefore recommend that users of the HVS Middle East Hotel Development Cost Trends consider the material presented here as a general guide, and that no investment decision should be based purely on these estimates without seeking validation of development budgets from specialised cost consultants. All individual property information used by HVS Consulting and Valuation for the development cost publication is provided on a confidential basis and is believed to be reliable. Data from individual sources are not disclosed.

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About HVS

HVS is the world's leading consulting and services organization focused on the hotel, mixed-use, shared ownership, gaming, and leisure industries. Established in 1980, the company performs 4500+ assignments each year for hotel and real estate owners, operators, and developers worldwide. HVS principals are regarded as the leading experts in their respective regions of the globe. Through a network of more than 30 offices and 450 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry.**www.hvs.com**

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About the Authors

Yasin Munshi is an Analyst with HVS's Dubai office, specialising in hotel valuation and consultancy. He joined HVS in 2012 and holds a BSc in Hospitality Management from Ecole hôtelière de Lausanne, Switzerland. Since joining, he has provided hotel investment advice and conducted valuations, feasibility studies, and other consultancy assignments across different asset classes in the Middle East, Asia and Africa. Yasin is fluent in English and French.
ymunshi@hvs.com

Hala Matar Choufany Hala Matar Choufany is the Regional Managing Director of HVS Dubai and is responsible for the firm's valuation and consulting work in the Middle East and Africa. She has worked on several mid and large scale mixed use developments and conducted numerous valuations, feasibility studies, operational assessments, operator searches and negotiations, strategy advice, return on investment and market studies in Europe, the Middle East, Africa and Asia. Hala has in-depth expertise in regional hotel markets and a broad exposure to international markets and maintains excellent contacts with developers, owners, operators, investment institutions and government entities.
Before joining HVS International, Hala had several years of operational and managerial hotel industry experience. She lectured at Notre Dame University in Lebanon on International Travel and Tourism. Hala is fluent in English, French and Arabic. Hala is an official Member of the Royal Institution of Chartered Surveyors (MRICS). She also holds an MPhil from Leeds University,U.K., an MBA in Finance and Strategy from IMHI (Essec- Cornell) University, Paris, France and a BA in Hospitality Management from Notre Dame University, Lebanon.
hchoufany@hvs.com