CREATIVE SOLUTIONS

Hoteliers can take a proactive approach to rising construction costs

By **SANJAY MUNDRA, CEO OF SVN HOTELS**


Image courtesy of Guerdon Modular Buildings.

The challenges we face in the hotel industry today are vastly different from what they were 30 years ago—even five years ago. The demand for new, innovative technologies and increasing customer service expectations are challenges with solutions well within hoteliers' reach. Other issues, such as guests' desires for a more meaningful experience, are being met through creative ideas such as soft brands and the retraining of staff. But perhaps the most concerning challenge of all is the rising cost of construction.

Labor and materials are arguably the two most critical components of any construction project. As the cost of these integral production components rise, hoteliers are being forced to consider cutting costs in other areas or scrapping projects all together.

According to the Bureau of Labor and Statistics, material prices rose 4.8 percent from February 2016 to February 2017 and 1.5 percent from February to this past October. This "sharp U-turn" in prices comes after an economic downturn and is being driven by the increased demand for buildings, rising energy prices, and a stable global market. International products, especially foreign steel, are now subjected to new tariffs at the insistence of U.S.-based manufacturers, tacking on extra costs to consider.

Economists predict a steady rise in pricing through 2019, with an increased demand in emerging markets and a decreased supply from bankrupt Chinese suppliers. Disputes between the U.S. and Canada caused the cost of lumber to rise from $366 per 1,000 board feet on February 3 to $391 on February 10. This marked the largest single-week price increase since August 2003. The price of lumber continues to steadily rise. With disputes still not settled and a new tariff enacted, lumber costs reached an all-time high in October 2017 to the tune of $410.40. Prices are expected to climb even higher by the end of the year.

Recent weather-related issues have caused setbacks, as well. As Hurricane Harvey ripped through the Houston, Texas, area and Hurricane Irma impacted the Southeast, the cost of materials has risen and shortages plague the industry. The immediate demand for plywood, wallboard,

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laborers, trucks, and more on the residential side has left many commercial projects struggling to be completed.

Material costs aren't the only thing increasing; equipment costs are also rising and impacting the overall cost of construction. In 2017, five key steel-related products, all necessary equipment, experienced a sharp increase in price: security wire fencing, nails, elevators, demolition machinery, and forklifts. In addition to the steel-supply crisis, the Bureau of Labor and Statistics has reported a shortage in other essential materials like aluminum, cement, and gypsum.

Finally, the skilled labor force is dramatically shrinking from what's being referred to as the "Skills Gap." This is a unique phenomenon in the U.S. that pressures the population to receive a four-year degree and places a stigma on blue collar workers. The void of skilled workers has resulted in 5.8 million jobs unfilled and a predicted 4.5 percent increase in construction costs.

The push for higher education isn't the only problem affecting the skilled labor population. Effects of the Great Recession of 2008 ripple through the construction industry even today. The economic downturn, which started in 2006 and lasted through 2013 for the construction industry, put a hold on many projects across various industries leaving lots empty and half-built projects lagging further behind. More than 10 years later, the construction industry still hasn't bounced back.

"Over the decades as we've gone through different rounds of infrastructure development, building the nation's suburbs, the highways, and the rest, those construction jobs have been a critical part of building a middle class," said Robert Dietz, chief economist for the National Association of Homebuilders. "The challenge right now is that we simply do not have enough people who are ready and willing and able to join the construction industry."

According to the Associated General Contractors of America, labor is still 11 percent below the 2006 peak. Large municipal and corporate projects, seasonal needs, and weather-related setbacks are causing a strain on the current labor force in addition to the increased need from the hotel industry.

As one of the fastest growing sectors in the world and an integral part of the hospitality industry, the hotel industry shows little sign of slowing down over the next few years. Hoteliers are having to work to offset the rising cost of construction amid the post-recession building boom.

How is the hotel industry cutting construction costs while still meeting guest standards?

Many brands, such as Marriott International, are adopting the building method of modular construction. As of this year, Marriott International is expected to sign 50 hotel deals, or 13 percent of their 2017 North American signings, that will incorporate prefabricated guestrooms and bathrooms.

Modular construction involves guestrooms and bathrooms being constructed off-site in a climate-controlled factory. Upon completion, the units are transported to the site where a base and frame have already been built. The units are stacked by crane and workers complete

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the mechanical, electrical, and plumbing systems while finishing other small details.

Marriott has already opened one modular hotel in Folsom, California. This 97-room Fairfield Inn and Suites was built by Guerdon Modular Buildings at their Boise plant and then transported to the Folsom site. Each unit contained two rooms that included a bed, a desk, and a toilet connected by a corridor. Incredibly, this project was completed two months ahead of time and avoided common construction problems such as weather setbacks and labor shortages.

"The reason Marriott and others are embracing the modular construction process is that it can dramatically shorten the overall construction schedule, which leads to quicker occupancy and quicker return on investment," says Tom Hardiman, executive director of the Modular Building Institute. "Overall, about 3

percent of all construction starts with modular construction in North America."

European markets, where space and materials are extremely limited and costly, have been quicker to adopt modular construction than their North American counterparts. But, with Marriott embracing the change, Hardiman feels that five to six percent of all construction being modular-based is not an unrealistic idea over the next few years.

Though Marriott currently only has their Folsom Fairfield Inn and Suites constructed using prefabricated guestrooms and bathrooms, they have four other locations in production using this method.

"A typical four-story select service property takes 12 to 14 months to complete," said Eric Jacobs, Marriott's chief development officer of Select Brands, North America. "Modular construction can decrease that to eight to 10 months."

And, just because a building is prefabricated doesn't mean Marriott is skimping on quality.

"We think the construction is better executed in the factory, so it's higher quality," said Karim Khalifa, Marriott's senior vice president of global design strategies. "With 100,000 rooms, some of those rooms look the same between hotels, so we can get that faster to market through a factory system."

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Modular construction isn't the only way hoteliers are cutting construction costs.

Bill Hoy, senior vice president of development planning and construction for Wyndham Worldwide, said that Wyndham properties will be dropping from approximately 54,000 square feet to 49,000 square feet by reducing the number of meeting rooms, cutting down on lobby size, and building smaller bathrooms for guests. For Wyndham, this means two more guest rooms can be added.

Future Hawthorn Suites will be similarly dropping from approximately 72,000 square feet to 54,000 square feet. Hawthorn Suites will then add 12 more guest rooms for savings of $42,000 per key during the construction phase.

Every square foot costs money. Air conditioning, maintenance, lighting, and future renovation costs make the potential lifelong return on investment less lucrative. Hotels are built to generate revenue. By controlling the square footage of the hotel and removing unnecessary area, the capital expenditure can be kept in check without sacrificing aesthetics and design.

Land and construction costs are going up overall, which shouldn't be a surprise, considering where we are in the economic cycle. As with any real estate, these costs tend to increase in the good times, as competition intensifies, but then drop and stabilize during the bad.

The industry as a whole has been affected by the rising costs of construction. Hoteliers may not be able to control why the cost of production is rising but they can control how they build and operate their business. By choosing new construction or planning methods, hoteliers can cut costs without cutting quality. hT

ABOUT THE AUTHOR

Sanjay Mundra is CEO of SVN Hotels, an international hotel brokerage firm headquartered in Raleigh, NC, and created by Sperry Van Ness International Corporation, a commercial real estate brand which generates more than $10 billion in transaction volume. Mundra has been involved in the hospitality business for more than 30 years.