

GETTING THE PROJECT RIGHT FROM THE START

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Cost over-runs on hotel projects have been common across the region. However, a look at cost data collected from various hotels built in India over the years reveals a certain homogeneity in construction costs for similar hotel products. Rather than cost over-runs, this points indeed to a poor budgeting process in the initial conceptual and design phase of hotel projects, over-optimistic cost projections, and over-designed hotels.

Under-budgeting leads to lower return on equity than originally thought and difficulty to service debt. Evidence shows that it also leads to construction delays and poor quality, all further contributing to higher IDC and eventually a Non-Performing Asset or even financial distress. Indeed, with the current practice of starting works before the design is complete, the reckoning of 'cost over-runs' only comes late in the construction process when, in fact, most of the costs have already been built into the areas constructed. This late 'wake-up call' typically leads to hurried re-design of interior spaces, delays in award of works, idle contractors for lack of drawings, purchase of sub-standard materials and, most importantly, award of works to unqualified contractors at unsustainable rates. Poor quality will affect not only the guest experience and the hotel revenues, but can also drive the hotel energy bill and maintenance costs to unsustainable levels.

Our survey has also revealed another hidden cost in poor hotel planning. Very often, there is a disconnect between the initial

market survey and its revenue-mix recommendations and the actual spaces designed. Costs are often cut by reducing the size or the functionality of genuine revenue-generating areas (e.g. meeting rooms) whilst other non-revenue or low-revenue generating spaces (e.g. F&B) are over-designed. Operational costs later soar as much as capital costs.

DID YOU KNOW:

- Unlike a cost per bay (standard room module), the **cost per key will vary** depending on the ratio of suites to rooms even though the overall hotel cost remains unchanged.
- The **cost per bay can vary by up to 30%** depending on the number of rooms, the size of F&B and public areas, the shape of the land, the local by-laws, and soil conditions.
- **70% of construction costs** lie in the total area built and hence can't be reduced after the concept design is finalised.

Then, one might wonder, why are so many hotels planned and designed on the simplistic and false principle of a cost per key, which has not been under-written by anyone or confirmed by any technical feasibility study? If the hotel operator is on board early enough, its technical services team will surely draw the owner's attention to the risk of over-building—however, the operator's attention is on GOP whilst the owner's incentive is ROE. A fancy specialty restaurant may marginally improve GOP and the hotel brand, but damage ROE.

Case Study

One and a half years into planning a hotel project, our client came to us with approved plans and drawings. The hotel operator had just come on board and given its mandated checklist of minimum requirements for its mid-market hotel brand. A renowned architect was on the team and the project was primed to go into design development. We were brought in as project advisors and our findings were as below:

- A gross area per room of 134 sq. m. while mid-market hotels are in the range of 65–75 sq. m. per room;
- 46% of non-revenue generating areas in the approved plans and designs;
- Estimated cost per bay of INR 1.1 Cr. whereas a typical mid-market hotel should be around INR 0.60 Cr. per bay;
- Several functional issues, that include restaurant layout in relation to number of rooms and expected house count, lack of elevators near key outlets, inadequate storage space, and guest and service crossings.

Ultimately, the plans had to be completed redesigned with a fresh and clear project brief in order to make the project feasible. The results were:

- Public areas were reduced to increase the overall efficiencies in the design. The gross area per bay was reduced to 72 sq. m.
- Revenue generating areas were increased by 11% by adding meeting rooms and additional grab-and-go F&B options.
- Budgeted cost per bay was frozen at INR 0.70 Cr. (due to a low room inventory) as a result of reduced public areas. A cost saving of 25% was achieved just by rethinking the area allocation.
- Functionality issues were corrected based on each specialised consultant's inputs.

Planning and designing the right hotel is difficult enough for a green-field development but it becomes particularly complex for a brown-field or a conversion project. Estimating the cost of works to complete a partly-built hotel or the cost of works associated with the Property Improvement Plan (PIP) of a running property requires a thorough technical due diligence. It is a complex balancing act of the building's technical limitations and the new owner's business objectives.

Hotel development is complex in nature and solid expertise is needed, most of all in the early stages of planning and development, the lack of which will most definitely result in cost over-runs and ultimately poor financial returns for the project. With this in mind, **HOTELIVATE and ASCENTIS** have brought together their respective business and technical expertise to offer advice to prospective hotel owners in those critical first months of development, with four major objectives:

- To confirm the technical feasibility of the hotel programme envisaged in the marketing feasibility and ensure its cost meets the ROI objectives of the business plan;
- To get the right team of consultants on board to design the hotel;
- To lead the concept design phase to develop a hotel that not only meets all the objectives of the business plan for costs and revenue-generating areas, but also outperforms its competitors with a superior guest-experience and higher RevPAR;
- To prepare a Project Execution Plan which will form the baseline for costs, timelines, and quality.

The PEPA services play a critical role in the timely and cost efficient completion of hotel projects. Along with detailed planning and proactive management of risks and opportunities, we build effective relationships with all project stakeholders to leverage their expertise and produce innovative solutions that build value for the project and our client's business.

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