

MGM GRAND DETROIT

A VALUE ADDED DEVELOPMENT STRATEGY

Introduction

The MGM Grand Detroit was a successful project that was opened ahead of schedule and under budget. The project won national design/development awards and became the highest revenue producing property in a local market of four major casinos complexes.

In addition to achieving these levels of success the development methodology produced many levels of added value that would not have been realized with “standard” development practices.

The purpose of this report is to highlight the metrics of this successful project and the business strategies employed.

Overview of the Casino Development Business

By most building industry standards the development projects organized by MGM Mirage are enormous. The size of these projects coupled with the need for speed in completion are unmatched in any other industry.

Unfortunately, with size and speed come high levels of risk for budget, schedule and control of quality. In most development sectors these risks can be greatly reduced by long term study, designing, plan completions, hard money bidding and longer schedule durations.

MGM Mirage does not have the luxury afforded to these other sectors. If MGM Mirage took the time to study, design, complete drawings and hard bid projects the operating results would be problematic 1) Projects would be late to market and slower company growth would be the result, 2) Designs would already be old by the time the project opened. This would be similar to GM or Ford designing a car today but selling it three years from now; not very competitive and a definite competitive disadvantage, 3) Unable to take advantage of continually changing technology and 4) Difficulty in reacting to developments of competitors.

Traditional MGM Mirage Development Strategy

Due to these development factors the MGM Mirage model for development has been to first hire an architect and general contractor and second to design while building. The contracting vehicles used in this model are “*Cost Plus a Fee*” or “*Guaranteed Maximum Price*” (basically Cost Plus a Fee until the drawings are developed enough for the General Contractor to guarantee a price). This type of real estate development is risky and provides little to no certainty for MGM Mirage in terms of cost, schedule or quality. It provides opportunity for contractors to avoid risk and maximize profits. While this methodology can produce wonderful looking/operating projects the results are often higher costs, reduced ROIs, late openings (delayed revenues), reduced quality, reduced project safety and disagreements/possible litigation with contractors.

An Innovated MGM Detroit Development Strategy

Recognizing these difficulties the Detroit development team innovated upon the traditional MGM Mirage development strategy and reorganized it into an organization that:

1. Met the Original Project Goals budget, schedule, quality, safety, and diversity.
2. Added Value of \$93.3 million to the Traditional Development StrategyThe cost of the MGM Detroit project was \$800 million using the MGM Detroit development strategy. The cost of the MGM Detroit project would have been \$893.3 million had it been produced by the traditional MGM Mirage Development Strategy. A discussion of this value added savings follows below.

The first step in developing the innovation of the Detroit project was the understanding that the use of general contractors in the MGM Mirage development model didn't reduce risks and worked against the probability of certainty in meeting the goals of cost, schedule quality, safety and diversity. Likewise, it was also believed that the use of a general contractor would limit the optimization of those results. But also understood was the fact that the general contractor provided needed experience, personnel and skills.

In response to these beliefs the Detroit development team reorganized the traditional development model. This new model eliminated the use of a general contractor and the traditional management by the owner's development staff. Replacing these traditional functions was a new smaller Development Team that only had the interests of the owner, thought like an owner, eliminated duplicity of tasks, enhanced ability to act quickly, simplified communications, tightened project controls and had the talents of experienced developers, operators and general contractors all rolled into one entity having identical goals:

Full-Time On-Site Detroit Staff — 32 total project management employees. 25 Construction Managers and 7 in Finance, Diversity and MGCB Compliance.

Part-Time Las Vegas Corporate Staff — 12 total employees who in addition to the MGM Detroit project managed the annual capital improvements at Mandalay Bay, Luxor, Excalibur and MGM Grand Las Vegas. Those members included:

Project Executive - SVP Planning and Development
Design Management -VP Planning and Development
Field Construction Management- VP Construction
Accounting and Control - VP Finance + 2 P/T Support Employees Purchasing -
Director of Purchasing + 2 P/T Support Employees
Director of Contract Administrator + 2 P/T Support Employees.

Large development projects like MGM Grand Detroit are said to be like "a puzzle with 5000 moving pieces." The smallness of the MGM Detroit Development team is the primary reason the original project goals were met.

Original Project Goals

1. Budget ... Under-budget by some \$5 million.

The Board approved budget was \$765 million. Construction began in September of 2005. In December of that same year a business decision was made to raise the level of the project to what was then termed "a category killer." The MGM Mirage Executive Committee and Board of Directors were informed. This decision to raise the budget increased the initial cost by more than \$40 million to a total cost of \$805 million; final cost was approximately \$800 million representing a \$5 million savings to the project. An important distinction should be made with the Detroit project. Although the project cost increased from \$765 million to \$800 million it was intentionally made for the purpose of obtaining a higher level, more profitable project. The final cost was an expected and freely chosen cost.

2. Schedule ... Property Opened 10 week ahead of schedule

MGM Grand Detroit opened its doors for business 10 weeks ahead of schedule and ahead of the Motor City Casino, Greektown Casino and Windsor Casino projects. It is also worth noting that the MGM project is much larger than the other three projects and all three were allowed to start at the same time. Our \$800 million project was 24 months, 2 weeks from first shovel in the ground to first guest in the door.

3. **Quality - The promise of a "First Class Product" was delivered**
The quality of the MGM Detroit (architecturally and craftsmanship) is second to none in its market and has already achieved prestigious recognition:

MGM Mirage Recognitions - The hotel design has become the inspiration for future hotel designs in Atlantic City.

National Awards - Annual Lodging Investment Summit "Development of the Year 2007" and the Gayot.com "Top 10 New U.S. Hotels of 2007."

Local Awards - Detroit Free Press "Restaurant of the year 2007" the MGM Detroit restaurants swept first, second and third place.

- 1st Place MGM Saltwater
- 2nd Place MGM Bourbon Steak
- 3rd Place MGM Wolfgang Pucks

Nightclub & Bar Magazine ranked MGM Club V "Top 100 2008"

4. **Safety - No loss of life/serious injury. MGM saved some \$4+ million on projected insurance costs.**
This was the safest project in the company. There were no serious injuries or loss of life. In fact the project ran at 25% of the Michigan average for loss of work days.
5. **Diversity - The Promise of high levels of Diversity was delivered.**

173 Targeted Businesses contracted for work.
120 Minority Businesses contracted for the work.

53% Total project spend with Target Businesses (Exceeded 30% Detroit Goal).
33% Total project spend with Minority Businesses.

32% of all Tradeworker hours were performed by Minority Trades workers (Exceed 25% Detroit Goal).

A side note: Levels of participation in Las Vegas are similar to the levels of participation found in Detroit. This is due to the innovated project delivery system used by the Las Vegas development group that worked in Detroit.

6. **Community Relations** - The image of MGM was enhanced.

Project "Close Out" - All Contractors paid.
Four months after the debut of the MGM Detroit project, all construction contracts (80 total) were closed out. A quick close out like this has several advantages 1) Future risks and obligations to the contractors has ended 2) Goodwill in the community 3) Development Team can focus on other company business. Likewise 98% of all Purchase Orders were closed out in the same period.

Detroit Value Added Process

The G&A costs of the owner's development team are normally just costs. The process employed by the Detroit team has extraordinary value added benefits. It not only greatly reduced the cost of administration but it significantly reduced the costs of the project, added to the control of expenses, controlled risks, increased project safety, added diversity and reduced the time to build.

The value added by the MGM Detroit model is estimated to be \$ 93.3 million and for discussion purposes is divided into two categories:

Calculated added value	\$ 56,300,000
Estimated added value	<u>\$ 37,000,000</u>
 Total Added Value	 \$ 93,300,000

Calculated Added Value

1.	General Contractor Fee Savings \$470 million x 3.2%	\$15,275,000
2.	General Contractor General Liability savings \$470 million x 1.25	\$ 5,875,000
3.	General Contractor Bond Savings \$470 million x 1%	\$ 4,700,000
4.	Owner's Staff, and General Conditions savings \$470 million x 2.5%	\$11,750,000
5.	Gaming Tax savings for opening 10 weeks early	\$ 5,800,000
6.	Capital Interest savings for opening 10 weeks early	\$ 8,500,000
7.	Owner Controlled Insurance safety savings	<u>\$ 4,400,000</u>
	TOTAL CALCULATED ADDED VALUE	<u>\$56,300,000</u>

Estimated Added Value

1.	Direct Owner Controlled Bidding	\$ 5,000,000
2.	Creative Contracting	\$15,000,000
3.	Owner Keeps "Float"	\$ 4,000,000
4.	Reduced Acceleration Costs	\$ 3,000,000
5.	Eliminate Hidden Costs and Fees	\$ 5,000,000
6.	Change Order Management	<u>\$ 5,000,000</u>
	TOTAL ESTIMATED ADDED VALUE	<u>\$37,000,000</u>

Estimated Added Value Comments

1. Direct Owner Controlled Bidding. A technically capable Owner will buy goods and services harder than a General Contractor. MGM Grand II recruited bid interest, managed the approved bidders list, received/ opened all bids, negotiated contracts, wrote contracts and administered contracts. The sealed bid process and opening assures the owner's best bid and eliminates bid rigging. Special payment terms could be negotiated directly between the Owner and Subcontractors. The decisions on who to hire for General Contractors can be much different than the decision making of Owners.
2. Creative Contracting. The goal of any General Contractor is to avoid risks and maximize profits; this often will result in additional costs or missed opportunities for Owners. With the Detroit project all contracting was directly between the subcontractors and owner. This permitted the Project Team to reduce risks to subcontractors and achieve the savings from those reduced risks. Example: 1) \$90 million of concrete work was performed at a 5% fee. Traditional mark ups for concrete work is 10% to 15%. 2) \$72 million of electrical work was performed at a 6% fee. Traditional mark ups for electrical work run 10% to 15%.
3. Owner Keeps "Float". General Contractors bill owners monthly for the work performed by the subcontractors. The payments are deposited into the General Contractor's interest bearing accounts. General Contractors delay making those payments to the subcontractors. Through elimination of the traditional General Contractor the Owner doesn't have any money sitting in someone else's account and reduction money cost. Owner funds remain in the possession of the owner.

4. Reduced Acceleration Costs. Costs to the Owner for accelerating the work to meet the schedule are eliminated because the Owner makes direct payments to the subcontractors and uses his ability to pay promptly as a means to move the schedule ahead without added costs normally charged by General Contractors.
5. Eliminate Hidden Costs and Fees. General Contractors obtain hidden fees that are very difficult to find. With the MGM Grand Detroit II acting as the General Contractor the opportunity for hidden fees or fees on top of hidden fees was eliminated
6. Change Order Management. - The loyalties between General Contractors and Subcontractors are stronger than the loyalties between the General Contractors and Owner. Simply put the General Contractors become successful when Subcontractors produce results. General Contractors favor Subcontractors who have performed for them in the past. General Contractors will spend more of the Owner's money for Subcontractors who take less management on their part. And occasionally General Contractors will go out of their way to repay Subcontractors for losses on project not associated with this Owner.