Embrace the Opportunities for Shared-Ownership in China's Tourism Market

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(Part II)

The Sharing Economy

China is undergoing a shift from a manufacturing and resource extraction led economy to a service-based economy, in line with rising incomes, a rapidly growing middle class and higher discretionary spending power. In the last decade, China's sharing economy has grown from a fringe concept to an economic powerhouse, reshaping various industries like tourism and mobility at a rapid pace. The sharing economy uses digital platforms to allow consumers to share access to underutilized assets at a price. The peer-to-peer nature of the industry has led to rapid increases in scale. For example, it took Hilton Hotels 93 years to operate a total of 600,000 rooms per year, while home-sharing site Airbnb added that many to its platform in just four years.

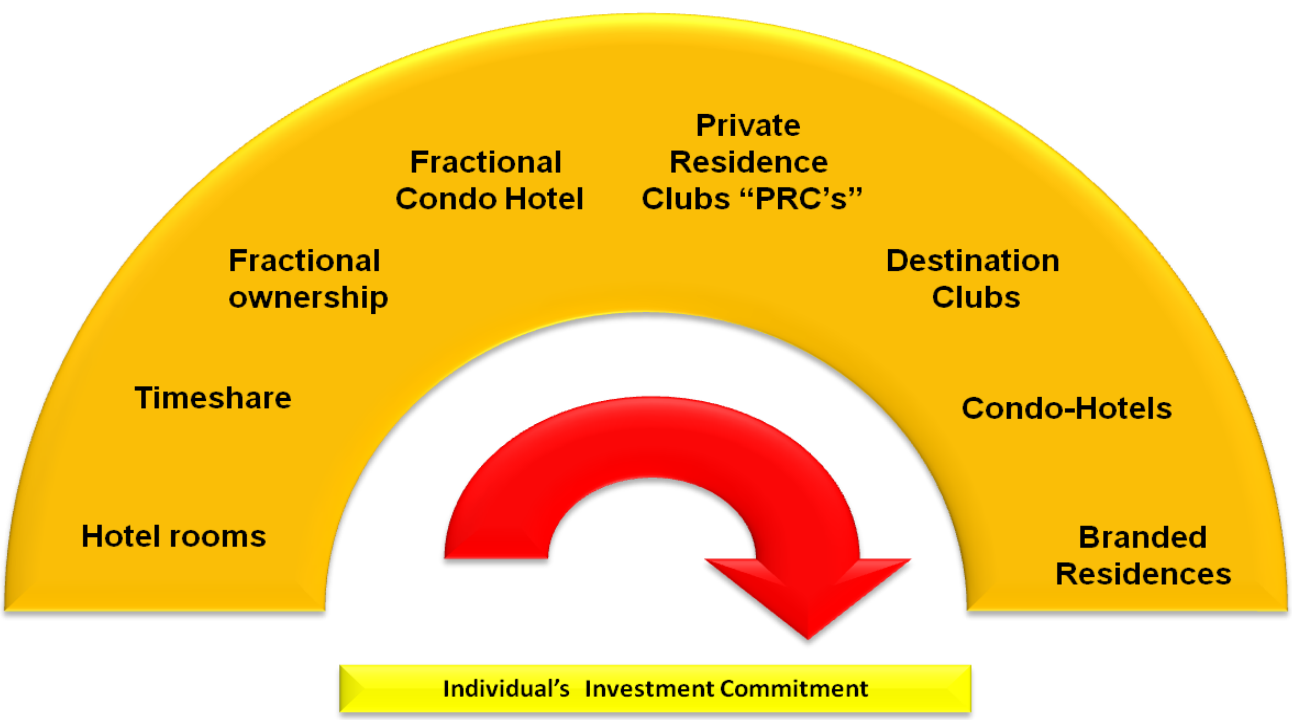
According to the World Economic Forum, consumption is on the rise in China; in 2016 growth in domestic consumption accounted for some 64% of domestic GDP growth and 20% of global GDP growth. A growing proportion of this consumer spending is going to the sharing economy. In 2015, the sector was reportedly worth $229 billion and is predicted to grow by 40% annually over the coming five years.

China's state information sector recently announced that by 2020, it could account for over 10% of domestic GDP, and that the ratio will continue to grow to roughly 20% by 2025. The report also says that the transaction volume of China's sharing economy topped $500 billion in 2016, up 103% year on year. During the past year, 600 million people were involved in the sharing economy in China, a surge of 100 million from 2015. Meanwhile, sharing economy platforms created 5.85 million jobs, an increase of 850,000.

Inspired by the huge success of companies that make a business out of sharing cars, bicycles and accommodation, China is experiencing a sharing boom, with increasing number of seemingly shareable products and services from accommodation to power banks, to basketballs, to baby strollers.

Shared Ownership Product Types

The diagram below illustrates the range of shared ownership accommodation offerings which have been successful across many international markets and also demonstrates the level of financial commitment made by an individual Buyer, which increases as you move from left to right.



Hotel rooms

Hotel rooms are often sold as an investment-type product when strata-titled, with buyers being offered specific levels of financial return, usually for a defined period, as well as some limited annual usage. The product probably has little appeal to large families or frequent multi-generational travellers as the hotel room will usually only accommodate two adults. This type of product was pioneered in Europe and in the Middle East and has been well-received in circumstances where a recognised hotel brand has been the Operator of the property but it can be a potentially challenging product where such management is absent.

Consumers' primary choices for Holiday Accommodation

	Hotel	Rental	Timeshare	FI/PRC	2nd Home
Advantages	flexible, brands, services	flexible, private	pre-paid vacation+ exchange opportunity	Sharing Economy, Exclusivity High Quality, Services Overlay	equity, ready availability appreciation in value
Disadvantages	smaller rooms, expensive when multiple rooms needed	unknown quality, Management & services Searching	limited services, weekly increments	Owners may compete for some peak time periods	expensive, security, ownership responsibilities maintenance, lack of services

Timeshare

The Timeshare product is structured in a variety of different ways, depending upon the jurisdiction in which the projects are located. Within the USA market, timeshare interests will usually comprise a right to the use of vacation accommodation, linked to a deeded real estate interest. In Europe and elsewhere, timeshare is more often structured as a "right to use" which entitles owner to use one or more weeks in the resort's accommodations together with the use and enjoyment of the resort's amenities whilst in residence. The "right to use" is usually conceptualised as a Club Membership. The unencumbered ownership of the timeshare accommodation units is held under the control of an independent Administrator to guarantee the Club Members' ability to exercise their future occupancy rights.

Purchasers of timeshare interests pay an initial purchase price (sometimes with the assistance of a consumer finance plan provided by the Developer) and thereafter, annual maintenance fees which cover the costs of maintaining the property and the provision of management services, utilities and insurance.

Some timeshare products are fixed time (e.g. the owner has the 30th week of the year, every year). Many Timeshare products are floating time programmes, where the occupancy rights will float within a defined Season, requiring the owner to make an annual reservation.

Timeshare is not an investment product. It is a holiday or leisure product where the value lies in its use over time, rather like buying a motor car. It will usually offer a significant saving on accommodation costs when comparing the cost of purchasing with the annual cost of renting similar quality accommodation.

Most Timeshare resorts are affiliated with a major exchange company, such as Interval International or RCI.

One particularly important point to understand is that timeshare and vacation club accommodations are ***significantly larger*** than standard hotel rooms. A typical hotel room, dependent upon location, might be in the order of say $30m^2$ whereas a one bed timeshare unit which may be able to sleep 4 persons in comfort would be around $70m^2$ and a two bed, sleep six persons unit would be in the order of $110m^2$. Timeshare units will usually have fully-fitted kitchens and large well-designed bathrooms.

The floor plans below illustrate the differences.

Vacation Clubs (also known as multi-site Timeshare plans)

Vacation Clubs were created when developers of Vacation Ownership projects began to focus on growth strategies based upon the development of a portfolio of geographically diverse resort locations, to enhance the appeal of their product and provide their Members with different holiday experiences and increased flexibility in usage.

Vacation Clubs also provide a means by which the developer brings consistency and quality to their customers' exchange experiences at other Vacation Ownership resorts. This ownership concept allows the developer to sell more than one Vacation Ownership interest. Major USA developers, such as Marriott, Hyatt, Hilton, Wyndham and Disney, all operate Vacation Clubs.

Most, though not all, Vacation Clubs adopt "vacation points," "membership points," "vacation credits" or the like as the currency by which members may exercise the right to reserve, use, and occupy the club's accommodations, pursuant to a set of prescribed reservation procedures. The reservation system is intended to maximize the collective use rights of all club members and may be susceptible to periodic point reallocations in order to alter the weight of the various demand balancing criteria. Vacation Clubs offer consumers the ultimate in flexible vacation options and related privileges.

Membership of this type of Vacation Club usually provides a Member with a designated number of points that can be used on an annual basis during the term of the Vacation Club's existence, to access the club's accommodations and facilities. Many Vacation Clubs also offer their members numerous ways to redeem their points for purposes beyond merely staying in the club's own accommodations, such as for cruise products, hotel stays or other travel related services and benefits.

For example, Hilton Grand Vacations Company, Marriott Vacation Club International and Starwood Vacation Ownership allow their members to exchange their club points for frequent guest points which can be used to reserve nights at hotels throughout the world. In addition, Vacation Club members can often redeem their points for discounted airfare, cruises, car rentals, and even merchandise.

Members can usually purchase or rent additional points from the developer, "borrow" points from a succeeding year, or "bank" unutilised points in a given year for use in making vacation reservations in the following year.

The table below identifies the various product types, their specific Buyer motivation, typical usage and the predominant product or unit type in terms of actual accommodation configuration.

Product Type	Buyer Motivation	Typical Usage	Predominant Product Type
• **Vacation Ownership** • **Timeshare** • **Vacation Clubs**	A quality holiday or leisure product and a way of fixing future holiday accommodation costs	One or two weeks of annual vacations	Studio, 1, 2 or 3 bed
Fractional Interests	Cost Effective alternative to vacation home; a lifestyle enhancement	3 weeks to 13 weeks per year	2, 3, 4 bed villa, townhouses and apartments (urban or resort setting)
Private Residence Clubs	Second Home alternative; Lifestyle commitment, often with branded service overlay	$1/7^{th}$ to $1/12^{th}$ fractional interests	luxury villas, detached vacation residences and apartments w services
Destination Clubs	Money-rich/time poor who need to escape to luxury environments	Basic 30 days but with extra time available if desired	4/5 bed super luxury properties in outstanding locations
Buy-to-Use-and-Let	Part enjoyment and part financial	At buyer's option – 30 to 60 days + space available	$600f^2$ to $1,500f^2$ apartments, sometimes with lock-offs
Branded Residences	Primary or secondary residence	Full ownership but sometimes with rental opportunities	Luxury accommodations with high specifications +services

Fractional Ownership

Fractional developers sell an alternative second home product, which provides expanded use rights along with extensive amenities and services. Fractions are typically between 1/10th and 1/4 ownership, giving the Fractional Owner between 5 and 13 weeks of flexible use per year.

The significant difference between Fractional products and traditional Timeshare products are the use of more spacious, higher specification accommodation inventory and longer use rights per year, as well as more usually, an actual ownership interest in the underlying real estate. Fractional owners regard this interest as an investment, as well as a lifestyle enhancement, rather than simply a holiday product so that it is, in reality, a hybrid product providing LIFESTYLE + INVESTMENT. Acquisition costs and annual fees are significantly higher than Timeshare. The exchange component of the Fractional product is very important with high-end exchange companies able to provide this additional benefit.

Private Residence Clubs

Private Residence Clubs are also fractional ownership products. Private Residence Clubs are in the upper end of the Fractional Products market. Private Residence Clubs are distinguished from other forms of Fractional interests by the extensive overlay of guest services, amenities, exclusive member benefits and privileges and are consequently marketed to the most affluent consumer groups. Fraction sizes are usually smaller for Private Residence Clubs as compared to traditional and high-end Fractional interests, ranging between 1/7th and 1/17th.

Subject to space available limitations, owners usually have unlimited use of facilities and lodging, a privilege they usually pay for through higher annual maintenance fees and in some cases a daily use fee. Branded developers and operators in this segment include Ritz-Carlton, St Regis, Fairmont, Four Seasons and Hyatt.

Comparative Advantages and Disadvantages of each Product Type

Product Comparisons

Range of Consumer Options

	Hotel	Private Rental	Vac Club	FI/PRC	2nd Home
Advantages	Easy to book, Choice of brands, choice of services	Flexible, Private, larger living space	Pre-paid vacation, exchange, larger living spaces	Premium Lifestyle, High Level of Service	Equity Investment Potential, always available, privacy
Disadvantages	Small rooms, expensive for high season and suites	Unknown quality, less services, more expensive	**No resale value for purchaser,** Service levels vary by resort	Premium Prices for fixing desirable usage periods	Expensive, absentee responsibilities for maintenance, lack of services & amenities

Financial attractiveness for both Developer and Consumer

Besides a number of very specific operating synergies that a shared ownership component can bring to a mixed-use development [predictable occupancies, reduction in seasonality peaks and troughs, incremental revenues through F. & B. spend, leveraging of existing resources, plus room nights taken for marketing purposes] there are financial benefits for both the Developer as well as the Buyer.

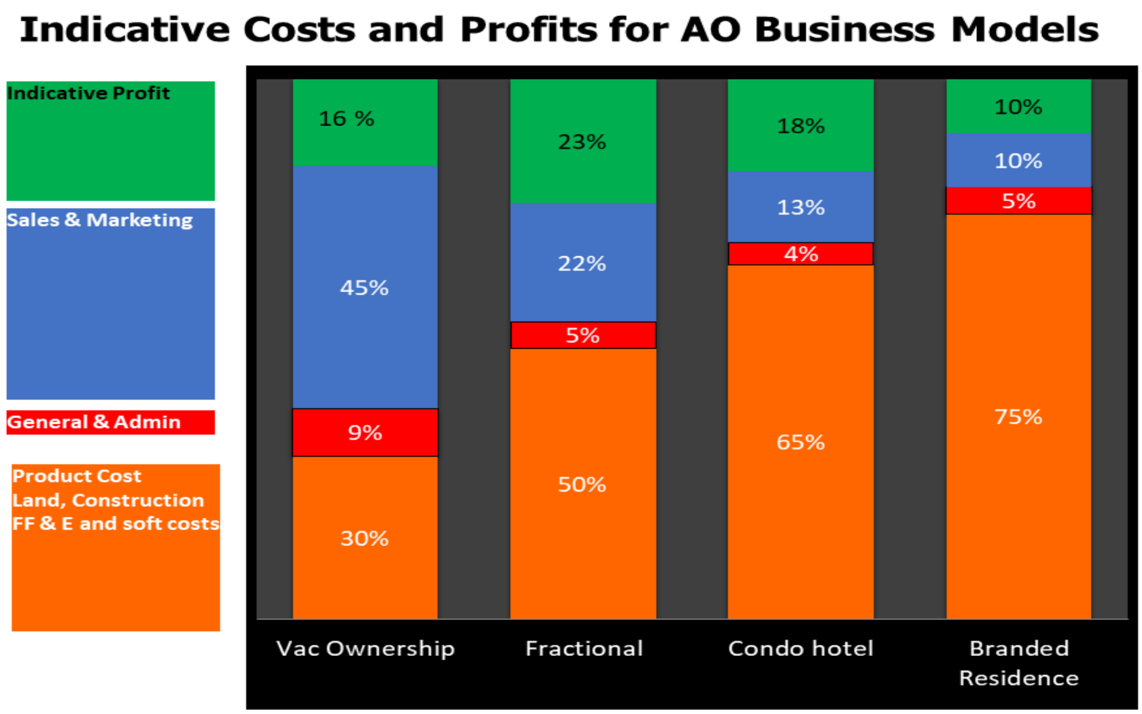
Developers should look seriously at this concept because of its commercial attractiveness

- Selling units by a time interval increases total pricing by 4 to 5 times (as compared to. whole ownership)
- Mark of Maturity: A natural extension of hotel/resort/residence business
- Utilize surplus land or unsold inventory and speed up sales of slow moving units
- Accelerated payback and increased IRR
- Potential to turn a financially marginal project into a financially viable one
- Provide lower debt & equity requirements for new developments or upgrading existing facilities
- Generate additional profit from consumer loan payment plans
- Generate profits from the resort management activity
- Depending upon product structure, opportunity to re-acquire asset at end of the Membership period

For Consumers, shared ownership provides a very cost-efficient way in which to enjoy quality vacation accommodations:

- Cost Effective alternative to second home purchase—pay only for the time that you will use
- Taxes and Insurance expenses shared with numerous other owners -the Sharing Economy
- Enhanced Vacation Experiences: Yuan saved on accommodations available for more activities on holiday
- Quality of accommodation guaranteed every year
- Annual Club Dues or Maintenance Fees ensure FF&E Upkeep & Replacement
- Flexibility – Multiple choices for destinations, unit types, number of nights and desirable seasons

The Business Models related to each Product Type



Some Final Observations

Consumers who are able to see, feel and experience the product are often excited by the quality and spaciousness of the accommodations and the related resort facilities. Consumer satisfaction levels recorded through independent research in mature markets is around 85% whilst annual occupancy levels at timeshare resorts in the USA was 79.9% in 2015 and is consistently reported at around this level. Predictable occupancies, on a year-round basis, help address seasonality issues found in some resort destinations.

Unlike the West, where such offerings have been structured for long timeframes of 50 or 80 years or even "in perpetuity", Chinese consumers prefer shorter term membership programs necessitating the development of new business models specifically for the China domestic market. Reluctance to pay annual maintenance fees is also posed as a difference, as well as a challenge for China-based products.

Historically, marketing costs for Shared Ownership products has been a significant cost, largely because Consumers did not understand the concept and needed to have it explained to them, as well as the need to bring the buyers to see the product [usually via short stay site inspection visits] rather than Developers being able to take their product to the market. This challenge is quickly changing because of the heightened use of technology, the offsite use of virtual reality capabilities, consumer connectivity via the internet with their mobile devices and the confidence which has been generated in recent years with online shopping and use of easy online payment platforms.

Thanks to the more active sales and marketing of world renowned Vacation Club Products and recent booming of sharing economy, the Millennial families are now more willing to accommodate new concept embedded in this highly-privileged product.

Of course, the development of Shared Ownership products is not without challenge in China. Lack of timeshare regulations and restriction on foreign investment in real estate has shied away many international Vacation Club brands from inbound development and sales of their Products. Domestic players have dipped their toes in the water for many years (e.g. platform to sell co-ownership held by up to 12 buyers, which serves as a hybrid of lifestyle and investment similar to a Fractional Ownership offer; Club Membership designed for elderly customers providing both leisure and healthcare service, which is akin to the point-based Club Membership of Timeshare Product) but none of them becomes mainstream business model responsive to the ever-growing market demand.

Having that said, now we are at a historical edge when the government from Beijing starts to place emphasis on the "use-right" over "ownership and investment" of residential and commercial properties, through the implementation of a series of policies and regulations. The Chinese preference of buying assets is about to change. With assets in hand, developers have every motivation of offering various and flexible leisure and accommodation products to survive and prosper in the market. It is now not a "to be" or "not to be" choice; instead, it is a matter of how to do it right.

Conclusions

There is a significant opportunity within the sharing economy in China, for Developers who hold quantities of recreational real estate inventory [whether high quality apartments or villas] or who may be about to develop a new resort project, to be able to monetize their inventory through the innovative use of new membership programs, by adapting existing shared ownership business models which are tailored to the holiday needs and preferences of Middle Class Chinese Consumers.

Platforms created to achieve such monetization create a number of very specific revenue streams for the Developer, including a higher yield on the real estate, the ability to earn profits through providing consumer loans to their buyers and highly profitable resort management operations from the provision of all necessary management and hospitality services to their Members, who will, over time, become a long-term captive customer base.

For Developers and Hospitality Groups wanting to know more about these Business Models and how they can be designed and implemented, they should be sure to attend AOCAP, 2018 – the Alternative Ownership Conference Asia-Pacific being hosted in Singapore on 28th and 29th March 2018 [website at: http://hicapconference.com/aocap] ■

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His expertise relates to all forms of Recreational Real Estate including Branded Residences, Condo-hotels, Fractional Interests and Private Residence Clubs plus vacation ownership. He provides feasibility analysis, financial modelling, concept development and product design, product legal structuring, usage plan design, preparation of operating budgets, reserve funding, marketing and sales strategies and subsequent project implementation.

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Michael is active in the hospitality and senior housing industry. He is a frequent speaker in real estate and hospitality seminars, such as Alternative Ownership Conference Asia-Pacific (AOCAP) and International Association for Housing and Services for the Ageing (IAHSA). He is also a lecturer of China's Legal Training Center, frequently deliver speeches on the topic of the practice on development and operation of commercial real estate.

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