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Developments

The Voice of the Timeshare Industry

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TIMESHARE'S BIG PICTURE IS CROWDED WITH NEW PRODUCTS.
WE ASK:

Where Do Fractionals Fit In?

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TIMESHARE VS. FRACTIONALS: NAMING BY THE NUMBERS

TO GET THE WORD ON WHETHER TIMESHARE'S TRULY DIFFERENT FROM ITS HIGH-RENT COUSIN, YOU'LL HAVE TO DO THE MATH

By Sarah Rezak

Taskey told the audience timeshare and fractionals were essentially the same; I said they were different. Who was right?

People often ask how fractional interests or private residence clubs (FI/PRCs) compare to timeshare. Well, to be scientific about it: they're the same, only different.

Ask this question to a developer or seller of the FI/PRC product, and you'll get a list of reasons why they're completely different products. But look at the legal documents the buyer signs at closing and you'll see they're fundamentally the same, as is the concept behind each. Very simply stated, both are shared ownership of real estate.

Essentially, the difference between the two concepts is their consumer. Because FI/PRC buyers generally have higher income levels, more discretionary income, more discriminating tastes and different expectations than timeshare consumers, the vacation product they desire is different. Because the consumers' demands vary, the sales approach, the price point, the services provided and the atmosphere are all different. At the end of the day, however, FI/PRCs are still shared ownership of vacation real estate, or timeshare.

At the ARDA Convention in Las Vegas in April, Ron Taskey of Star Resorts surprised a group of more than 100 people by explaining to them that fractional interest marketing and sales are not that different from timeshare marketing and sales. However, not 10 minutes before, I told the same audience that sales paces, closing rates, marketing costs and rescission rates are all different. Who was right?

We both were.

Product Differences

The first and most obvious variance between timeshares and FI/PRCs is the size of the existing markets. Ragatz Associates estimates that there is a total of about 1,810 timeshare projects existing in the United States (1,250), Canada (110), Mexico (300), and the Caribbean (150). By contrast, the FI/PRC market in North America consists of 61 existing projects in the moderate- and high-priced tiers, and an additional 50 or so older fractional interest projects selling mostly quarter shares and affiliated with one or both of the two major timeshare exchange companies. Thus, there are somewhere in the neighborhood of 110 FI/PRC projects in North America, but Ragatz Associates focuses primarily on the 61 in the two highest tiers, as that is the growth area in the industry today. There are at least 26 additional FI/PRC projects in these two tiers that plan to start sales later this year.

One important reason for this disparity is the length of time each concept has existed. Timeshare dates back to the early 1970s, while the FI/PRC idea did not really catch on until 1995. [*It's true that the fractional market only recently became an established one, but the case can certainly be made that fractional interests have existed in less successful forms since timeshare's inception. – Ed*]. Roughly 70 percent of timeshare projects in North America started sales before 1990, yet the higher tier FI/PRC projects hadn't started sales until 1995, and 45 percent of FI/PRC projects have started sales since 1999.

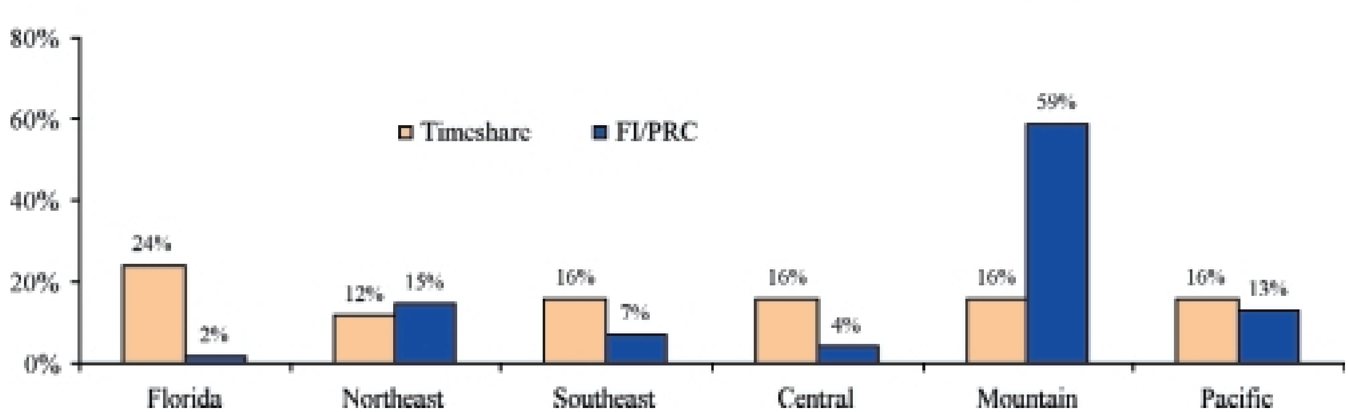
The locations of FI/PRC projects and timeshare projects also vary. Ragatz Associates estimates that about 24 percent of all U.S. timeshare projects are located in Florida, with the remainder fairly evenly spread throughout the various regions of the country—16 percent in the Pacific region, 16 percent in the Mountain region, 16 percent in the Central region, 16 percent in the Southeast and 12 percent in the Northeast.

Yet, as you can see from the graph below, FI/PRC projects are much more concentrated in the Mountain region. The concept began in ski destinations, where land costs are high and available land is scarce, as an alternative to a million-plus dollar second home. Fully 59 percent of existing FI/PRC projects are located in western mountain destinations. Only two percent are located in Florida.

Most (52 percent) timeshare projects were built to be sold as such; the remainder consists of conversions from condominiums (22 percent), hotels/motels (12 percent), apartments (five percent) and other uses (eight percent). On the other hand, a much smaller proportion of FI/PRC projects are conversions. Fully 88 percent were purpose-built to be sold as FI/PRCs. Five percent were built as condos, three percent as single family homes, two percent as timeshare, and two percent as hotel/motels. Because the FI/PRC consumer has demanded high quality unit design, construction and FF&E (furniture, fixtures and equipment), conversions have been less common. However, with the existing demand for urban locations, conversion projects will have to become more common.

On the whole, FI/PRCs tend to be larger units than timeshare projects. Units with three and four bedrooms are more common in

Regional Locations of FI/PRC and Timeshare Projects in the U.S.



Most timeshare salespeople still feel that when a tour leaves the

typically recontact their prospects four or more times before

FI/PRCs than in timeshare projects; 36 percent of FI/PRC units currently available contain three or four bedrooms, yet the same holds true for only seven percent of timeshare units. At the other end of the spectrum, 42 percent of timeshare units are studios or one-bedroom units compared to only 25 percent of FI/PRCs.

It should not come as a surprise that FI/PRC units are larger than their timeshare counterparts. The graph below shows the average square footages for each category of unit among both types of projects. The difference between the two averages increases with the number of bedrooms in the unit. For example, the average timeshare studio unit is 500 square feet, while the average FI/PRC studio unit is 520 square feet. This creates a difference of 20 feet, or four percent. On the other hand, the average timeshare four-bedroom or larger unit is 1,800 square feet, compared to 2,900 in a FI/PRC four-bedroom or larger unit. This is a difference of 1,100 square feet, or 61 percent. Across all unit types, the average timeshare unit measures 1,000 square feet, which is about three-fifths the size of the 1,720 square foot average FI/PRC unit.

One of the most important differentiating factors between timeshares and FI/PRCs is the services offered, or not offered, by each. Typically, timeshare ownership involves simply the shared ownership of a condominium unit or resort property. On the contrary, FI/PRC projects almost without exception, offer both pre- and post-arrival concierge services – anything from arranging tee times and taking skis from storage to the ski valet to stocking the refrigerator with groceries and placing family photos in the unit. Year-round storage, while found at over 80 percent of FI/PRC projects, is rarely found at timeshare projects.

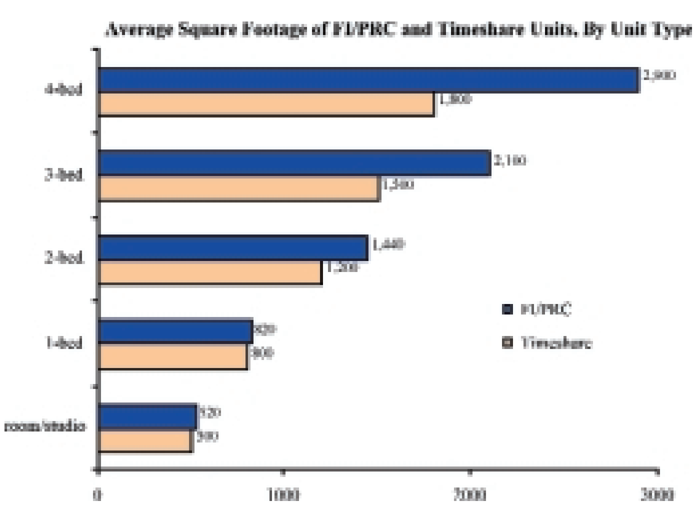
Free transportation, including anything from airport shuttle service to the use of an SUV during the owners' visit, is offered at 60 percent of FI/PRC projects, and ski or golf valet services are also common – offered at over 50 percent of FI/PRCs. While many timeshare resorts are built adjacent to or in the same development as golf courses, few offer priority tee times or greens fee discounts, yet these perks are offered by 47 percent and 38 percent respectively, of FI/PRC projects.

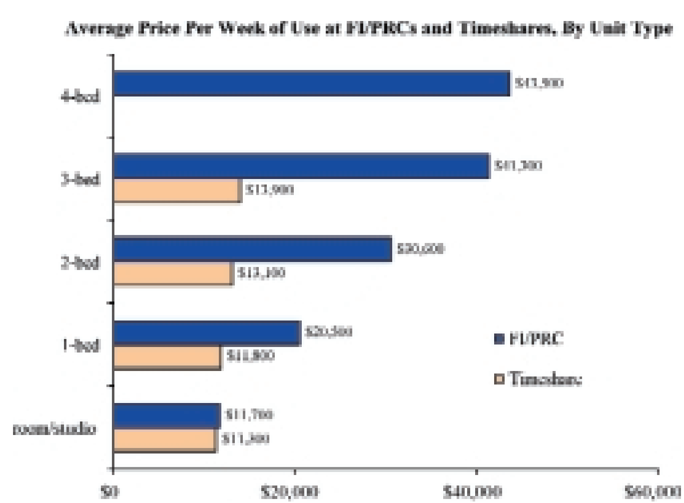
Since FI/PRCs provide higher levels of services, it is not surprising that maintenance fees are higher here than at timeshare projects. The average timeshare owner pays $360 annually in maintenance fees compared to $870 per week owned paid by the average FI/PRC owner.

Of course, the costs of the units themselves are also higher. At $34,000, the average FI/PRC costs nearly three times that of a timeshare interval per week of use. The costs of an average weekly timeshare interval range from $11,300 for a room or studio unit to $13,900 for a three-bedroom or larger unit. FI/PRC fractions, on the other hand range from $11,700 for a room or studio unit to $43,500 for a four-bedroom or larger unit for the same period of time, as demonstrated by the chart below.

Real estate professionals often advertise price per square foot when selling homes or condos. While these terms are not heard as often among timeshare developers, they are quite common for FI/PRC developers. This value should not be confused with the construction cost per square foot; price per square foot is calculated by multiplying the price per share times the number of shares sold and dividing by the square footage. For example, a timeshare project selling 50 weeks per year in 1,000-square-foot units at an average price of $10,000 per week would have a price per square foot of $500 (50 weeks times $10,000 per week divided by 1,000 square feet). The average price per square foot among FI/PRC projects in the North America is $930, approximately one–third higher than the timeshare price per square foot of $610.

Just like with most real estate, price per square foot decreases as units get larger. For room/studio units, the average timeshare costs $1,030 per square foot, compared to $1,130 per square foot for the average FI/PRC. The average price per square foot among three-bedroom timeshare units is $460, compared to $880 for FI/PRC projects.





sales center, they're no longer a prospect. Fractionals sales people closing. The difference? About double the close rate.

Sales & Marketing

Clearly, the product offering of FI/PRCs has both similarities and differences to that of timeshares, but what about marketing and sales? In both cases, the product is shared ownership of real estate. The consumer has to be made aware of the offering, then has to be asked to purchase the product. But, because the consumer is different, the approach will be different. The same marketing methodologies used by timeshare projects are used to attract consumers to FI/PRC projects, but the higher-income FI/PRC consumer has different expectations, and consequently, must be treated differently.

As the sales approaches vary, so do the sales statistics. The average timeshare project in the United States sells about 65 intervals per month, which works out to 780 per year. The average FI/PRC project sells only 12 shares per month, or 144 per year. Luckily for FI/PRC developers, each fractional sale brings a great deal more money than each timeshare sale.

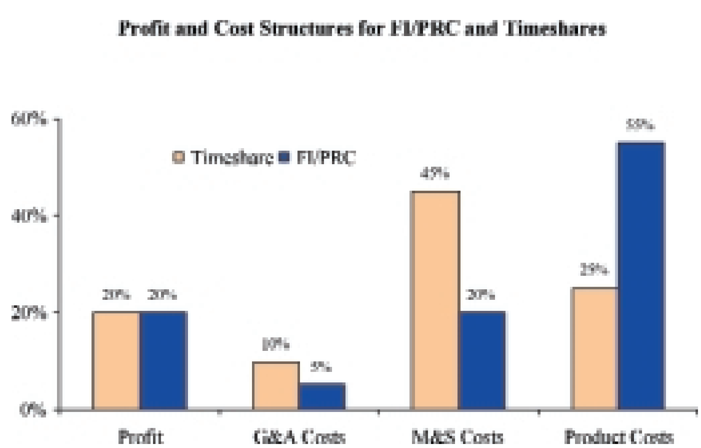
Another difference concerns closing rates. While the be-back mentality is becoming more common among timeshare projects, most salespeople still feel that when a tour leaves the sales center, they are no longer a prospect. The average timeshare closing rate is about 10 percent. FI/PRC salespeople, on the other hand, typically recontact their prospects four or more times before closing a contract. With this repeated communication, the average FI/PRC closing rate is about 20 percent.

On average, timeshare purchases are made utilizing financing offered by the developer in three out of four sales. Yet, despite the significant cost differences, FI/PRC shares are most commonly purchased with cash – in three out of four sales. FI/PRC's higher income consumers obviously have less difficulty making large cash purchases than do timeshare purchasers. They also usually have access to financing at lower interest rates than can typically be offered by the developer.

While profit margins tend to hover around 20 percent for both timeshare and FI/PRC projects, the cost structures are typically quite different. For a timeshare project, sticks and bricks, or construction costs, make up only 25 percent of sales volume. Marketing and sales costs eat up another 45 percent and general and administrative costs average 10 percent. However, for most FI/PRC projects, much more of the sales price is represented by product cost – typically 55 percent. Thus, in order for FI/PRC projects to remain profitable, marketing and sales costs have to stay around 20 percent and general and administrative costs around five percent. The drawing below illustrates these cost and profit structures.

Obviously, there are pros and cons with each type of offering. Timeshare projects offer a great deal more opportunity for profit from carrying or hypothecating receivables. FI/PRC projects offer a shorter sellout period. They also have less moving parts, and thus, are less complex.

But let's get back to our initial question: is a fractional interest a timeshare? Yes … and no. The jury's still out—but the developers are still flooding in. **D**



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Since joining Ragatz Associates in 1997, Ms. Rezak has made contributions in over 75 vacation ownership consulting assignments, including business plans facilitating the entry of developers into the timeshare industry, feasibility analyses, economic impact analyses, and consumer surveys.

Ms. Rezak organizes the annual Ragatz Associates Fractional Interest Symposium. Her work in this fast-growing segment of the industry has been published and cited in numerous trade publications.

Ms. Rezak is an active member of American Resort Development Association (ARDA), participating on the Membership Committee. She achieved her ARP designation in 2001 and is currently a candidate for RRP designation.