BARRON'S ONLINE

Monday, May 29, 2006

The New Time Shares: How to Avoid the Traps

By Robert Campbell Rowe

FRACTIONAL OWNERSHIP, INTERVAL OWNERSHIP, destination clubs. If these phrases are unfamiliar, how about "time share"? The new terminology "solved the problems that hindered the industry in its early days, horror stories of folks being swindled" by shady, undercapitalized time-share developers, says Sherman Potvin of Luxury Fractional Guide, an online service.

Call them what you may, shared vacation homes are booming. More than 4 million people in North America now own time shares, and the number is swelling by 300,000 a year, says consultant and author Lisa Ann Schreier. But, while the industry has largely cleaned up its act, buyers can still face a host of problems in everything from reserving dates to selling out. One thing hasn't changed: Caveat, emptor.

The time-share concept arrived in the U.S. from Europe in the 1960s, peaked in the early "Eighties, then fell into decline for more than a decade, despite the arrival in the business of Marriott, Disney and other big lodging brands. A typical time share was for a week or two, usually at a mountain or beach resort. Some ownership interests were conveyed by deeds, others weren't. Most could be bought and sold by their owners and placed in pools to be swapped for weeks at other locations.

Time shares have been rebounding in popularity in recent years, and by the late "Nineties the industry became marked by a growing emphasis on luxury. The term "fractional ownership" took over. Then came the introduction of "destination clubs," with yet fancier properties, fatter price tags and resort-level services. Thousands of people already have signed up for these.

The shared homes may be villas or apartments operated by a big-name hotel company, or they may be part of a network of fancy houses, sometimes called "private-residence clubs." Colorado and Florida are the two most popular states for fractional-ownership properties. All of them heavily promote amenities: concierges, spas, children's programs and an array of sports. Prices for shares run from $50,000 to $5 million, with annual expenses ranging from a few thousand dollars to well over $50,000.

There are essentially two types of ownership: equity and non-equity. Equity ownership is backed by a deed or, for those organized as corporations, a stock certificate, almost always in perpetuity. With it comes responsibility for taxes, insurance, maintenance and improvements. Non-equity stakes are also known as "right to use," or RTU, shares.

There are advantages and disadvantages to both, and a buyer of either should closely scrutinize the offering, preferably in the company of a real-estate lawyer and an accountant. As equity deals grow more popular, pressure is growing on RTU clubs to cut their members in on property appreciation.

Such potential could be part of the lure for fractional buyers in the ski country around Aspen, Colo. Knock-downs there sell for well over $1 million and houses often command $5 million-$10 million -- the perfect setting for sharing.

In Aspen, national-brand hospitality and resort operators are well represented in the fractional-ownership business. There and elsewhere, a big name offers a sense of security that a project is on solid footing, and it's usually affiliated with similar properties in other vacation locations, offering swap opportunities.

At the Ritz-Carlton Club in Aspen, a deeded one-twelfth interest in a two-bedroom apartment currently sells for $280,000, with annual fees running $10,900. A similar interest in a three-bedroom unit is listed at $360,000, with a $14,000 annual fee.

A potential drawback: The vacation weeks in these interests are spread throughout the calendar -- two in the winter, the peak season; one in the summer, or off season; and one in the least desirable periods. Also, each member's weeks differ from year to year, rotating among the 12 owners on a schedule determined by management. It's not possible, in other words, for one owner to monopolize the Christmas-New Year's week or spring break, or entirely avoid the unpopular mid-January and muddy spring weeks.

SELLING SHARES CAN POSE PROBLEMS FOR a member. One owner of two shares at the Ritz-Carlton bought in 2000, discovered too late that pets weren't allowed and that his dog would have to vacation elsewhere. The first share took more than two years to sell and the second one is still on the market. "I don't know if the other share will ever sell," the man said. "There are a lot of others on the market." On the share he was able to sell, he merely broke even after expenses. Had he been in a rush to sell, he probably would have had to slash his asking price and take a big hit. If he had asked the club's management to sell the shares, it would have taken a 10% commission -- higher than the typical charge by non-management brokers. And management, which still has unsold shares, would have set the price. Savvy buyers will seek out local brokers in the likelihood of getting a better price.

Pressure on resale prices at desirable locations can be explained largely by competition from new development. In Aspen, for example, new hot spots magically appear while shares in older places can go unsold. Next door to the Little Nell, Aspen's legendary luxury hotel, a fractional-ownership club broke ground last July. Completion of the 19 three-bedroom apartments and seven four-bedroom units is now expected in March 2008. A deeded share entitles an owner to four weeks a year, with a possible two-week bonus. As of this month, 60% of all units have been sold, and there have been six price increases in nine months, according to R.J. Gallagher, managing director of sales and marketing. The three-bedroom units were originally priced at $1 million and are now offered at $1,425,000. The four-bedroom units started at $1,350,000 and are now offered for $2,250,000. None of the units can be resold until the construction is complete and certificates of occupancy have been issued.

Gallagher says "a significant minority" of the buyers so far are purchasing multiple shares, hoping to improve the odds of getting desired weeks.

However pricey an equity deal in Aspen or elsewhere, it's the non-equity side that has the greatest potential risk. "You're parking your money in somebody else's garage," says Gregory Shove, who last October started Heliumreport.com, an online newsletter dedicated to covering destination clubs.

Among the questions a buyer should ask of these deals:

- What is the ratio of members to properties? The more members or shares to a given number of properties, the lower the chance of getting a desirable period.
- How does one sell a membership?
- How many members are currently trying to sell?
- What are equity levels? That is, how much is the project leveraged, an indication of its financial strength.
- What are the reserve allowances? Like a condominium association, a vacation club must reserve for repairs and other contingencies.
- Who owns and operates everything?

The most fashionable of the current non-equity destination clubs are built around collections of stand-alone luxury residences in resort areas. Increasingly, fancy flats in places like London, Paris, New York and San Francisco are part of the mix.Under a typical formula for non-equity clubs, there is a membership fee of $250,000-$400,000 plus annual fees of $15,000-$25,000. Memberships can run 30 years or indefinitely. Most operators promise that 80% of the membership fee is refundable after two years. But there's a hitch, known as "two-in, one out," or "three-in, one out." This means that until the club's membership is fully subscribed, there must be two or three new members before fees on an existing membership can be refunded. If other members also want out, join the queue.

A greater risk turns on a club's long-term financial health. This, after all, is a new business model with no lengthy track record, and supporting a super-luxury format could prove capital intensive and a daunting challenge.

ONE CLUB, DREAM CATCHER, CURRENTLY HAS 20 homes in 18 destinations. The average value of each house is $3.25 million. The club states that it has a members-to-homes ratio of five to one, which it claims is better than most. "Our current membership is close to 100," says CEO Scott Anderson, who adds that no one currently is seeking to sell. The stated goal is a maximum 400 members and 50-60 homes, which means the five-to-one ratio will rise.

Membership in Dream Catcher runs $325,000 plus annual costs of $18,150 for 30 days' use. "If for any reason, you leave the club anytime after two years, you'll get a refund of 80%," says the club's brochure. It acknowledges that "you may have heard horror stories about other destination clubs being slow, reluctant or even refusing to honor their promise to refund membership deposits."

One of the most outspoken critics of non-equity clubs is Stan Dobrin, owner of Destination Developments. He recently merged his one-house club with Crescendo, which has seven houses. Dobrin warns buyers to be wary of clubs claiming to offer bonds or insurance as guarantees of membership refunds. "I've seen some of these documents and I can tell you they're full of holes and weasel words."

Tanner & Haley is a hybrid of equity and non-equity memberships. It is the pioneer in the non-equity field and claims to be almost as big as the industry's largest entrant, Exclusive Resorts.

"We are committed to a three-to-one property-to-member ratio," says Rob McGrath, founder and CEO of T&H. The company has leased several properties in order to meet peak-period demand, but this can backfire when members complain about the quality in leased backup units.

McGrath says he aims to offer all members something in the area they want to visit. "With high ratios, the members can't go when they want to," he says, referring to his competitors. "There are a lot of little wannabes who are starting to hit the wall on getting new members."

With 2,000 members and growing fast, Exclusive Resorts—majority-owned by America Online founder Steve Case—is definitely not a wannabe. "We see this growing to tens of thousands of members," says

CEO Donn Davis. "This is a lifestyle investment for members of high-net-worth households."

THE BOTTOM LINE

The unscrupulous operators have been thinned out, but the industry still requires real care on the part of buyers. Selling a fractional interest can prove to be especially difficult.

ER has three levels of ownership: 15-day use for $195,000 plus $9,500 in annual dues, 25 days for $295,000 and $17,500 in dues, and 45 days for $395,000 plus $25,000 in dues. ER now has 280 residences, divided about equally between stand-alone houses and apartments, with an average value of $3 million. The company plans to add 110 more. A survey taken by management found that "96% of our members are satisfied," Davis says.

Some equity clubs offer memberships registered with the Securities and Exchange Commission. One is Ventures, headquartered in Tampa, Fla. Ventures now has eight houses. It will add several more but has a stated goal of just 72 members. Ventures is contractually committed to selling all the houses within eight-to-12 years, depending upon market conditions, and distributing 60% of the gains to the membership while the founders take 40%. Management calculates that at 10%-20% annual appreciation, the members will come away with an annualized return of 2.5%-7% each. Meanwhile, members get 28 days plus 14 bonus days. The upfront equity commitment is $250,000 plus annual dues that are expected to average $30,000 over the next 10 years.

But any form of time sharing still carries some peril. Reselling shares, for instance, can mean a loss of 25%-50%, after commissions are counted. In other words, ownership shouldn't be viewed primarily as an investment, but as a prepayment for vacation time.