Hotel Investment Strategies

Timeshare 101: The Interval Ownership Explosion

The timeshare industry has recently emerged from a business characterized by undercapitalized developers looking for quick profits, unethical boiler room salespeople making unfulfilled promises and thousands of individual buyers losing their vacation savings. Today, legitimate hotel companies such as Accor, Carlson, Disney, Hyatt, Marriott, Starwood and even Four Seasons have entered the interval ownership arena. If you think your hotel is a candidate for a timeshare component, let me provide you with some basic guidelines to facilitate your decision-making process.

Quick Cash Flow Needed

While the large hotel chains such as Marriott and Disney have the capital to create and sell freestanding timeshare projects, most ordinary investors will need to quickly generate cash flow from all the units during the three- to five-year sales process. This is generally accomplished by "timesharing" an existing hotel that has an established revenue base. As the inventory of hotel rooms are converted to interval ownership, hotel room revenue is replaced by timeshare unit sales and maintenance fees.

While this concept sounds fairly simple, most timeshare buyers are looking for more than an ordinary 350-square-foot hotel room. They generally want a full kitchen, large living area, separate master bedroom, and probably another bedroom for the kids. Simply selling your individual hotel rooms will not work. The solution is to either combine several existing hotel rooms and do a total gut renovation, or build a separate timeshare wing or freestanding building. Both options require a substantial capital investment along with the inevitable disruptions to your normal hotel operations.

If you think you can create the appropriate physical facilities to attract today's interval buyer, the next step is to evaluate your sales and marketing expertise. Success in the timeshare business requires a coordinated sales machine capable of funneling thousands of potential buyers through your property and converting the lookers to owners. My advice in this matter: If you do not have an experienced timeshare marketing and sales infrastructure in place, then find a joint venture partner or sales organization that does.

Start-Up Expenses

Look for some of the hotel chains to start facilitating the sales process through timeshare branding and selling assistance. Expect to invest from 1% to 2% of the project's anticipated unit sales in initial marketing programs and start-up expenses. Of course, this is a relative estimate that will achieve some economies-of-scale based on the size of the project and the depth of pre-existing distribution channels. Afterwards, getting people to purchase a timeshare interval will usually run between 40% to 50% of the interval's selling price.

The economics of a successful timeshare project can be excellent, with profits flowing from three primary sources: the sale of the interval itself; the treasury or loan-making operation; and retention of other operating assets and management.

Most timeshare developers target a 10% to 15% profit margin on the retail sales price of their product, with very successful projects achieving 20%. Thus, on the cash purchase of a US$10,000 interval, the gross profit margin will be US$1,000 to US$1,500 per week. The key to achieving this profit potential is holding the construction and sales costs in line and selling out the project as rapidly as possible. Excess construction costs, long carrying periods and ineffective marketing will quickly erode the developer's profit.

In regions where timeshare is financed, money can be made from the arbitrage between the interest rate charged to the interval owner and the rate paid by the developer to obtain financing.

For example, assume a timeshare buyer wants to finance the purchase of a US$10,000 interval. The developer typically requires a minimum 10% down payment and offers the buyer a five- to seven-year loan with an annual interest rate of 15% producing a first year's interest payment of US$1,350 (assuming the receipt of a 10% initial down payment). At the same time, the developer borrows US$9,000 at perhaps a 9% interest rate from a bank that requires an initial interest payment of US$810. The US$540 difference between what the developer receives from the unit owner and what must be passed on to the bank is another source of profit.

Profit-producing Assets

The third source of income for a timeshare developer is the retention of profit-producing assets such as a restaurant, golf course, health spa and other similar recreational facilities. In addition, the developer will continue often managing the completed timeshare project and charge the unit owners a fee that typically ranges between 7% and 12% of the annual timeshare owners' maintenance or operating budget.

Not every resort is a candidate for a timeshare conversion or development. Perform a market-feasibility and cash flow study that quantifies the interval sales price and selling pace, as well as profit potential from the treasury operation and other assets. These revenue sources are then compared to the total development costs, along with selling and other expenses, to determine the profit remaining for the developer. If your project shows a sufficient potential and you can line up the necessary expertise, then introducing a timeshare component may be one of your best synergistic operations or exit strategies for your hotel. ◆

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