PRICEWATERHOUSECOOPERS

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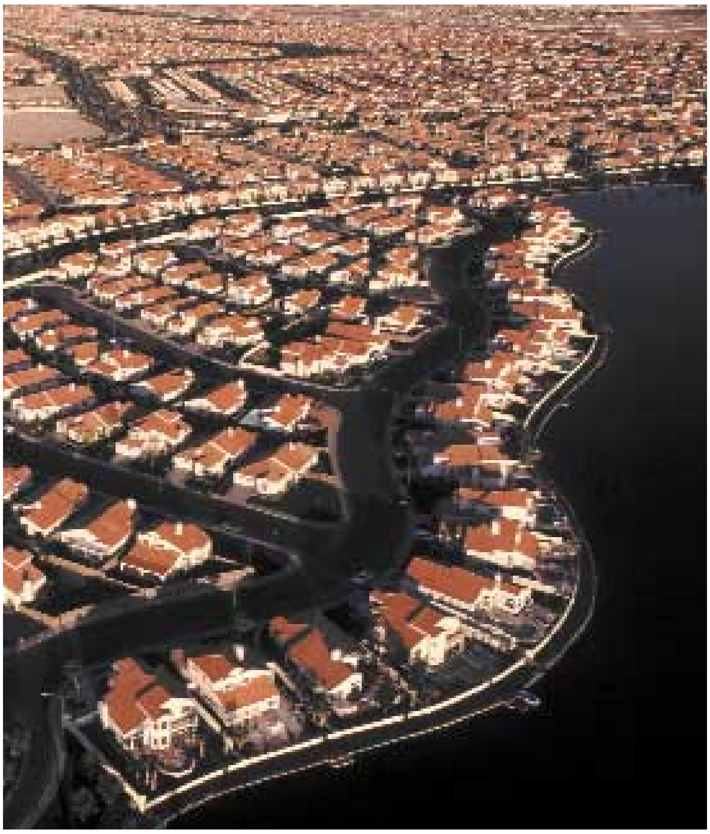
The changing face of timeshare in Europe



Timeshare was originally a European idea but has proved to be a concept that has developed fastest in the USA. Indeed, predictions of explosive growth for timeshare in Europe have not been borne out, despite the fact that there are now around 1.3 million timeshare owners in Europe compared with 460,000 in 1990. Why then should European timeshare appear less dynamic than in the USA? What are the prospects for the sector in Europe from the investor/developer's point of view?

This study looks at timeshare and its derivatives in Europe – such as fractional ownership, Private Residence Clubs and points clubs. The evidence suggests that timeshare from the developer's standpoint has the potential to earn above-average rates of return, but that its long-term future in Europe depends on a number of key factors. Chief among these is the extent to which the current legislative and regulatory environment, which has been built by national legislatures around the framework of the European Union's 1997 Timeshare Directive, can be more closely harmonised across Europe and a better balance achieved between the interests of the consumer and those of the developer.

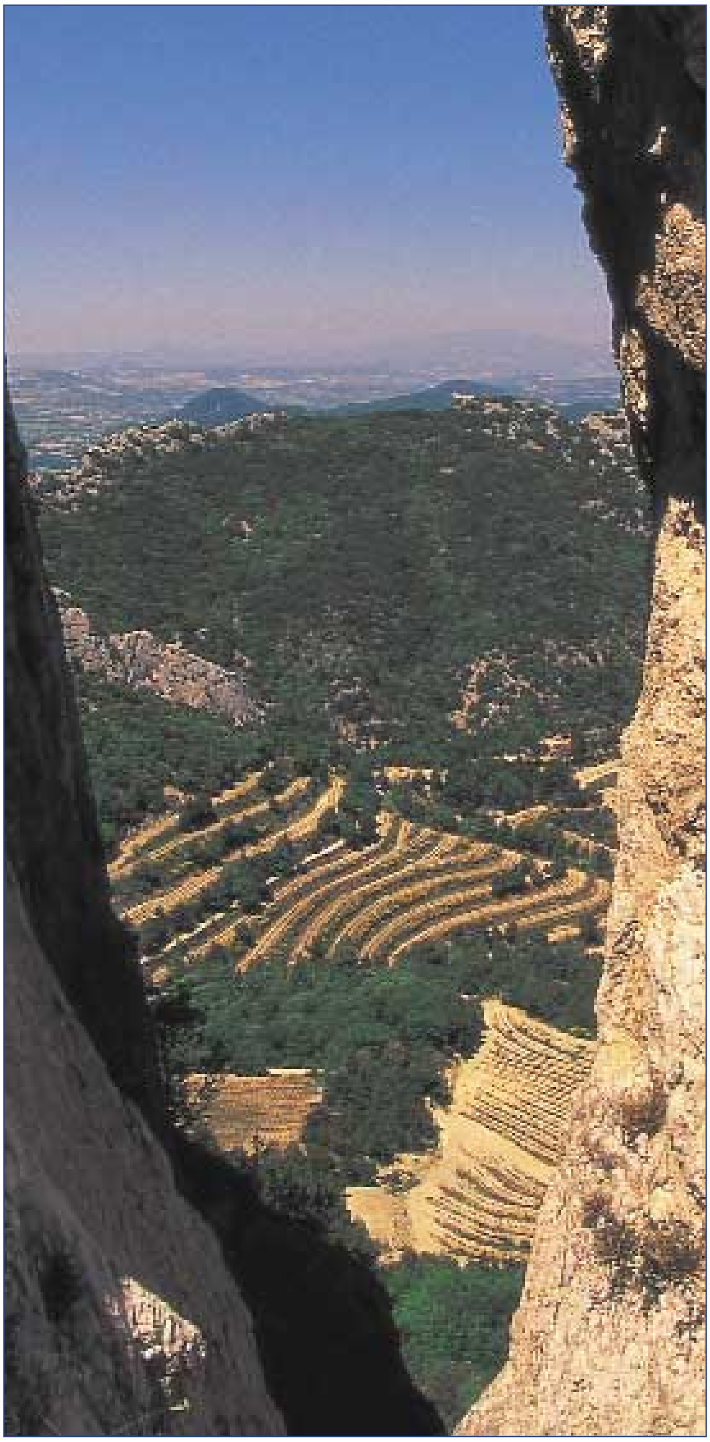
The second key influence is the extent of the involvement of some of the major branded hotel companies in the timeshare sector. In the USA, major companies such as Hilton, Marriott, Disney and Starwood have entered the industry, raising the profile and credibility of timeshare as a consequence. In Europe, branded hotel companies are now entering and/or expanding their activities in timeshare, helping to counteract some of the negative images that have dogged the sector in the past.

While there are many who express buoyant optimism about timeshare's future in Europe, the fact remains that its penetration into its most promising market segments remains low. This study assesses the prospects of that penetration increasing and looks at the resulting potential from the developer's and investor's point of view.

*connectedthinking

The industry in a nutshell:

- 1,450 timeshare resorts, and
- 3.75 million weeks of accommodation, and
- 1.3 million timeshare owners in Europe in 2001 (latest data), but
- fewer timeshare owners in Europe now than four years ago
- branded hotel groups now entering the market
- quality standards rising
- changing perception of the industry
- new models being developed
- regulation is a key issue



Definitions

"Timeshare" has become a generic term covering a variety of models which provide partial usage or ownership rights to holiday properties. Professionals active in the sector stress that the investment made by individuals in a timeshare product should be seen as an investment in holiday facilities, not as a property investment (although some of the newer variants do have a property investment element – see later in this report).

Timeshare can encompass a number of different concepts, the most prominent of which are:-

- **"classical" timeshare schemes**, the essence of which is that the user purchases an interval – typically in multiples of one week – in a holiday property with the right to use the unit each year, typically for a fixed term of between 20 and 80 years; such weeks can be for fixed dates, floating dates or sometimes on a split week basis depending on the precise terms of the deal; the owner pays in addition an annual maintenance charge and generally acquires no equity interest in the unit purchased (although early versions of timeshare, especially in southern Europe, were sold in perpetuity); other than where a deeded interest in property is sold, if the owner wishes to dispose of the unit during the period of his/her lease, he/she can only sell the time period for the residual number of years left on the original lease period.

- **fractional ownership**, a concept also associated with the acquisition of business jet aircraft or boats – under the terms of which the purchaser acquires part-ownership of the equity in a unit within a given property; typically the fractions purchased are divided into larger proportions of a year than with timeshare – often between 1/6th and 1/10th of a year; thus the initial cost is far greater than in the case of timeshare, as are the regular maintenance fees, the target market is more affluent and often the quality of the property in which the fraction is acquired is higher than the mass market timeshare. In the USA the destination profile of fractional ownership resorts is rather different from that of the traditional timeshare product and there is not the same focus on beach resorts – the primary location is ski areas (52 per cent), followed by golf (23 per cent), beach (20 per cent) and urban (3 per cent).

- **Private Residence Clubs** – this concept is akin to the fractional ownership model and operates at its most exclusive end with costs to match. In the USA hotel groups such as Ritz-Carlton and St. Regis are active in this area. The investment, which is for a fixed number of days – usually somewhat fewer (averaging 1/7th – 1/8th fractions of a year – i.e. 6-7 weeks - in the USA) than traditional fractional ownership – operates in a manner similar to membership of an exclusive club. These developments – again as with fractional ownership – tend to be smaller and in ultra-attractive destinations. The target market is those with high incomes and high liquidity. Sales and marketing costs are quoted as representing about 30 per cent of costs, compared with traditional timeshare's 50 per cent.

Fractional ownership/private residence clubs

Both fractional ownership and Private Residence Clubs (PRCs), although growing rapidly in the USA, are still at a very immature stage of development in Europe. A new developer of this concept in Europe, Great Hotels Organization, categorises fractional developments into three types:

Traditional fractional
- Town homes in regional resort areas
- 4-star resort service and amenities
- Selling for under €4,500 per square metre
- Price range €80,000-€175,000 for a 1/6th (2 months) fraction
- Buyer profile: €100,000+ household income; €800,000 net worth

High-end fractional
- Town homes in resort areas
- High-end construction and furnishing quality
- 5-star level of service and amenities
- Average selling price range €4,000-€9,000 per square metre
- Price range €180,000-€250,000 for a 1/6th (2 months) fraction
- Buyer profile: €150,000+ household income; €1.5mn+ net worth

Private Residence Clubs
- Top tier urban and resort locations
- Extraordinary architecture and design
- Highest level of service and amenities
- Selling for €9,000+ per square metre
- Average selling price €160,000-€320,000 for 3-5 weeks membership
- Buyer profile: €200,000+ household income; €2.5mn net worth

- **Points clubs** – whereby the purchaser acquires rights through a points system to the use of holiday properties which are priced according to season and location, and confer the right to occupy properties in multiple destinations as a result. Initially, points were awarded as a form of "currency" to holders of an interval – whether fixed, floating or split – but a later US model is now available in Europe from companies such as Macdonald and Sunterra where points can be purchased directly without the need to buy any interval, and can then be used either to buy time in a company's timeshare units or hotels, or traded through exchange companies for other resorts or indeed for an increasingly wide range of travel services.

Holiday Property Bond

This system is based on a life assurance bond which invests in a portfolio of holiday properties and securities. In return for a financial investment of a minimum of £4,000, bondholders are allocated a certain number of "points" enabling them to holiday in the HPB properties for an appropriate number of days and time of year. Investors pay initial charges and there is a quarterly fee of £24, with other management charges paid from securities. Bonds may be cashed in after two years, although because of management charges this may result in a loss in the early years. Bondholders look to see an asset appreciation in addition to their entitlement to holidays in the scheme's 1,000+ units. The bond is a lifetime investment which can be passed on when the purchaser dies.

- **Condo hotels**. A further variant on interval ownership is to be found in the condo hotel model. In essence, this offers an equity-based ownership of a unit – typically a hotel room, studio or a one- or two-bedroom apartment within a hotel setting – whereby the unit owner is entitled to a certain number of days' usage and also benefits from rental income when the unit is let out to other guests. Typically, a condo hotel is set at the upper end of the market, in the USA is frequently under the management of a recognised branded hotel company, and offers a full range of common amenities such as food and beverage outlets, fitness centres, swimming pool, spas etc. In the USA this model is attracting considerable interest among both developers and operators, and according to the National Real Estate Investor, (October 2004), is also attracting the ready participation of financiers. While condo hotels cost 25 per cent more to build than a standard hotel, National Real Estate Investor states that returns are also high – 25 per cent - 30 per cent compared with 10 per cent - 12 per cent for hotels.

GuestInvest

A recent European example of the condo hotel model is to be found in the UK under the name of GuestInvest. Initiated in London and subsequently extended to a small range of provincial UK hotels, GuestInvest invites investors to purchase a 999 year lease on a hotel room, in return for which the purchaser receives 50 per cent of the room's rental income, the right to use the room for 52 nights a year at a flat rate of £20 per night, and full maintenance and cleaning services as per normal hotel room practice. The lease can, of course, be sold on and the investor theoretically benefits from any rises in property values. To date, GuestInvest has properties only in the UK.

- **Partial hotel conversions**. Also along these lines is a scheme under development by Interval International, whereby an existing hotel agrees to set aside, say, 30 per cent of its room stock for conversion to fractional ownership and sale on a right-to-use basis for, typically, 25 years. It is argued that such schemes provide a useful up-front cash-flow benefit to the hotel and help in raising average occupancy rates in the remaining 70 per cent of hotel rooms above the level that they would otherwise obtain.

Table 1: Timeshare owners in Europe, 1990 and 2001('000)	1990	2001	Average annual growth (per cent)	Per cent share 2001
UK/Ireland	220.0	442.0	6.5	32.1
Germany/Switzerland/Austria	70.0	348.1	15.7	25.3
France	60.0	102.0	4.9	7.4
Scandinavia	40.0	97.7	8.5	7.1
Italy	40.0	93.2	8.0	6.8
Spain	3.0	67.4	32.7	4.9
Portugal	15.0	27.4	5.6	2.0
Benelux	9.0	57.4	18.3	4.2
Other	3.0	139.0[a]	41.7	10.1
Total Europe	**460.0**	**1,374.2**	**10.5**	**100.0**
Total exc. other	**457.0**	**1,235.2**	**9.5**	**89.9**

Note: [a] 2001 totals include Russia, Turkey and "other Europe" and may not be comparable to the 1990 "other" total
Sources: 1990 data from Travel & Tourism Analyst No. 2 1991, Economist Intelligence Unit; 2001 data from The European Timeshare Industry in 2001, Organisation for Timeshare in Europe

The ability to exchange timeshare ownership rights for usage rights in other properties, affiliated resorts or for a wider range of travel services is a key element in attracting timeshare purchasers. Exchanges are made either through one of the two main timeshare exchange brokerages – RCI or Interval International – but also through internal exchange schemes. For example, major hotel companies have the option of adapting their guest loyalty schemes to include timeshare owners or allowing owners to exchange their points for hotel stays. In the case of the two main exchange brokers, RCI is by far the larger of the two, with 450,000 European members in 2004 (of which 200,000 in the UK), while Interval International had 150,000 at that time.

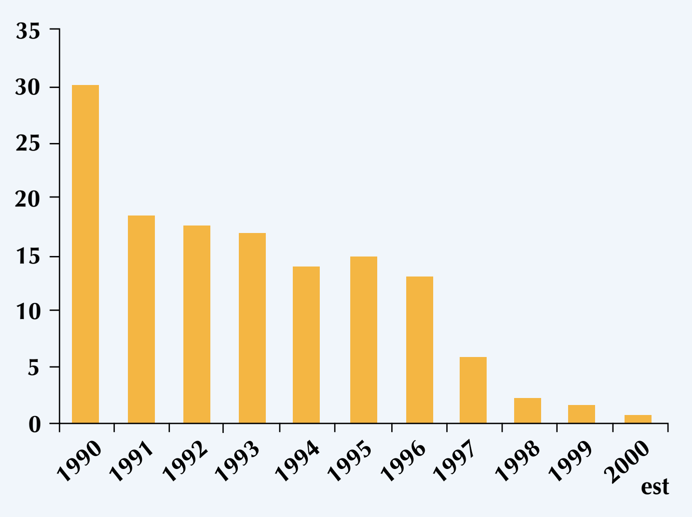
Market trends in Europe

Growth in timeshare ownership

Timeshare development in Europe has lagged behind that of the USA. There are around 7 million timeshare owners in the world with the USA accounting for over half of the total and Europe under 20 per cent. While growth in the USA has remained buoyant throughout the first years of the current decade, the increase in the number of owners in Europe is reported to have remained sluggish at best, with some commentators (The Timeshare Consumers Association for example) stating that the number of owners has actually declined. Whatever the details, there is no doubt that in recent years timeshare has not fulfilled its anticipated potential and the trend rate has declined.

Data suggest that in Europe between 1990 and 2001 (the latest year for which details exist), the rate of growth in the number of timeshare owners across Europe was of the order of 10 per cent a year on average. However, the Timeshare Consumers Association (Chart 1) shows that annual growth in ownership in Europe declined almost every year from 1990 to 2000 – from almost 30 per cent in 1990 to a virtual standstill by 2000. Among the reasons given for this was the implementation in 1997 of the EU Timeshare Directive which inter alia, banned the taking of deposits during the newly-introduced cooling off period, the growth in real wealth in Europe which revived interest in outright second home purchase, and the adverse effects of malpractice in timeshare marketing and sales which did serious damage to the sector's standing and credibility.

Chart 1: % increase, year on year, of timeshare ownership in Europe



Source: Timeshare Consumers Association

There are no firm data on ownership trends beyond 2001, but industry opinion canvassed for this report suggests that, overall, demand has been static and has even possibly declined. However, the market is also segmenting to the extent that higher quality, often branded timeshare facilities and newer forms of timeshare such as fractional ownership have been generating growth, while demand for the old-style mass-market timeshare product has been much weaker. Companies such as De Vere and Hilton International (based in the UK) are of the opinion that lacklustre growth is in part due to the lack of branded timeshare products active in the market in the past – a trend in which the USA is several years ahead of Europe. These brands are beginning to emerge in Europe and seem to be generating growth even as the bulk of the timeshare market stagnates.

Where are the owners?

The UK/Ireland is the largest timeshare market in Europe with 440,000 owners in 2001. The German-speaking markets have maintained their second place (with Germany individually the second largest national market after the UK), but have grown much faster during the 1990-2001 period than the UK/Ireland. Scandinavia is the third largest market, with strong demand both for domestic and Mediterranean properties. The fastest-growing country demand over this period has been in Spain where demand increased on average by over 30 per cent a year between 1990 and 2001.

Market trends: The UK, Germany and Scandinavia will remain the main feeder markets for timeshare in the overwhelmingly largest destination, Spain. Overall, commentators agree that the UK will remain the dominant market for the short to medium term – although a surge in UK real estate purchases in Spain has had a detrimental impact on timeshare sales there. While Germany is, and is likely to remain the number two market, the country's recent economic malaise coupled with the fact that timeshare has a less positive appeal in Germany, has meant that the German market has not fulfilled the potential expected of it nor is it regarded as offering strong growth prospects. The other traditional source markets, Italy, France and Spain are expected to do well. Spain, in particular, is likely to grow domestically, encouraged by the entrance of several Spanish hotel groups onto the market. Scandinavians, in the context of a strong economic climate, are continuing to purchase.

Both Finland and Hungary are showing strong growth, but these tend to be primarily domestic markets.

Of the emerging markets, the Eastern European countries including Russia, Poland, Hungary and the Czech Republic and Slovakia are being watched with interest. Mediterranean destinations have seen a large influx of holidaymakers from these origins and clearly timeshare purchase trends tend to mirror the broad patterns of mass market holiday-taking. However, it is generally regarded as too early to say whether the beginnings of growth in these markets represents the habits of a small band of wealthy purchasers or whether it will be representative of a more general trend. Mention was also made of an emerging Middle Eastern market, particularly from the Gulf. Although the bulk of Middle Eastern purchases are domestic, commentators have also noted the emergence of a market for Europe.

Timeshare resort development

About a quarter of the world's timeshare resorts are located in Europe. Although the absolute number of resorts has increased steadily since the birth of the industry, the rate of growth has declined since its peak at the end of the 1980s and exacerbated by the introduction of the Timeshare Directive in 1997. Today, statistics vary but it is estimated that there are currently in the region of 1,300 – 1,500 resorts throughout the region and that there has been only slow growth in the last four years. This contrasts sharply with the USA where growth has remained buoyant during the current decade and where the industry has not been dogged by the regulations, bad publicity and unscrupulous marketing practices that have beset the industry in Europe.

Where are the resorts?

The largest concentration of timeshare units is in Spain – and in particular in the Canary Islands – which, according

Table 2: Location of timeshare resorts in Europe by major country, 2001

Country	Resorts	Per cent share	Units	Average Resort size
Spain	512	35.3	29,244	57
Italy	186	12.8	12,375	67
France	142	9.8	9,850	69
UK	129	8.9	4,010	31
Portugal	124	8.5	7,654	62
Austria	55	3.8	3,230	59
Greece	45	3.1	2,225	49
Turkey	38	2.6	3,381	89
Germany	38	2.6	2,163	57
Switzerland	37	2.5	1,465	40
Finland	31	2.1	1,404	45
Scandinavia	40	2.8	1,595	40
Malta and Cyprus	35	2.4	2,319	66
Other Europe	40	2.8	2,111	53
Total	**1,452**	**100.0**	**83,026**	**57**

Source: The European Timeshare Industry in 2001, Organisation for Timeshare in Europe

Table 3: Distribution of resorts in Europe by major type, 2001 (per cent share)

Country	Beach	Countryside and lake	Urban	Ski and mountain
Spain	90.7	6.2	0.3	2.9
Italy	38.4	17.3	3.7	40.4
France	34.0	18.8	6.9	40.2
UK	16.8	75.2	5.3	2.7
Portugal	84.8	10.1	2.5	2.5
Austria	0.0	41.3	3.8	55.0
Greece	86.4	9.1	2.3	2.3
Germany	8.3	54.2	4.2	33.4
Switzerland	0.0	19.3	0.0	80.7
Finland	15.8	49.2	3.5	31.6
Scandinavia	36.8	25.8	7.3	30.1
Malta and Cyprus				
Total Europe[a]	**60.3**	**29.0**	**4.0**	**29.7**

Note: [a] Total resort percentages do not total 100 because the survey records some resorts in more than one location category and does not contain categorisation for just over 5 per cent of European resorts.
Source: European Timeshare Industry in 2001, Organisation for Timeshare in Europe.

to the OTE report entitled The European Timeshare Industry in 2001, has over a third of all the timeshare resorts in Europe. Together with Italy (12.8 per cent), France (9.8 per cent), UK (8.9 per cent) and Portugal (8.5 per cent), these five countries account for almost two-thirds of all Europe's resorts. Bearing in mind the predominance of the UK and German-speaking countries in the timeshare market, it is not surprising that the lion's share of resorts – again, well over two thirds – is located in Mediterranean destinations, reflecting the mass movement of people from Northern Europe to the south in search of sunshine.

Market trends: Current destination trends show that the top destinations in Europe remain the Canary and Balearic islands, mainland Spain, Portugal and Madeira, which are all high density resorts. (It should be mentioned that Florida, particularly, is a popular destination for Europeans and offers competition for Mediterranean resorts.) The UK too is proving popular, particularly for the domestic market, which frequently views it as a sound investment for a passport to other holiday products and destinations. Many UK purchases are made within driving distance of the owner's home.

Of the less mature destinations, Greece, Cyprus and Italy are beginning to generate more interest and operators make particular note of the potential offered by Croatia and possibly Montenegro. Turkey is also frequently mentioned although lack of security appears to put it on the back burner.

What type of resorts are most popular?

Leisure travel is the main motivator for the bulk of timeshare activity. As in North America, beach resorts are and will remain the backbone of the industry in Europe, certainly as far as the traditional timeshare product is concerned. In 2001 some 60.3 per cent of resorts and a slightly higher proportion of units (63.8 per cent) were located at beach locations. Countryside/lake and mountain/ski were in equal second place, with each category accounting for just under a third of capacity (some resorts fell into more than one designation), but urban timeshares represented a very small percentage (4 per cent) of total supply. In the US, sales of timeshare in ski destinations have been particularly strong but European ski resorts have not seen equivalent large scale developments and developers have proved cautious of the viability of ski areas as a profitable year-round investment.

More recent trends are revealed by Interval International and Marriott's regular survey about consumers' timeshare preferences. While beach locations remain firmly in first place, there is evidence that urban locations are rising in popularity. On a scale of 1 to 10 where 1 is the most important, beach locations scored 3.5 out of 10 in 2004. Four years ago the urban location was in 7th or 8th place with a score of around 7.25 out of ten, but last year had risen to second place with a score of 3.65 out of 10 – almost as high as the beach product.

Table 4: Summary of the leading timeshare players in Europe, 2004				
Exchange companies	**Total owners**	**Points owners**	**No. of resorts**	**Base**
RCI	450,000	38,000	700	UK (US owned)
Interval International – Europe	150,000	0	na	UK (US owned)
Developers/managers				
Hapimag	136,000	0	62	Switzerland
Sunterra Europe	97,000	45,000	34	UK (US owned)
Club la Costa	50,000	24,000	20	Spain & UK
Holiday Property Bond	33,000	0	28	UK
Anfi	30,000	1,000	5	Spain (Canary Is.)
Resort Properties	30,000	0	5	Spain (Canary Is.))
RMI Consortium	27,500	10,000	5	Spain & Gibraltar
Macdonald Hotels & Resorts	27,500	2,000	9	UK
Timelinx	25,000	0	1	Spain
Diversified/Crown Resorts	22,500	0	6	Spain
Pestana Group	18,000	0	7	Portugal
Clube Praia d'Oura	18,000	0	2	Portugal
"John Palmer"	18,000	0	12	Spain (Canary Is.)
Mondi Ferienclub	15,000	0	9	Germany/Austria
Lanzarote Beach Club	Was 19,000[a]	0	1	Spain (Canary Is.)
Select Vacation Club	13,000	13,000	8	Spain (Balearic Is.)
Heritage Resorts	12,500	0	6	Spain
Club Finland	12,000	0	9	Finland
Regency Resorts	9,000	0	5	Spain (Canary Is).
Sub-total	594,000	133,000	234	
All others	700,000	5,000	1,075	
TOTAL	**1,294,000**	**138,000**	**1,309**	

Note: [a] closed 5 February 2004
Source: Timeshare in Europe, 2004 – An Industry at the Cross Roads, Timeshare Consumers Association

Market trends: For traditional timeshare, beach resorts will continue to fuel the bulk of sales. While urban properties and ski resorts are generating increasing interest – particularly in the case of fractional ownership - and are likely to grow proportionately faster, it is beach resorts that will continue to account for the greatest volume. For the newer timeshare models, urban properties, in particular, as well as country and niche destinations, appear to be proving of particular interest among developers and purchasers.

Who are the main players?

The table above lists the main players in the European timeshare sector in 2004. (Note that the number of units that each principal company has at its disposal is not published.) The six largest companies in 2001 accounted for 30 per cent of all owners in Europe, while the top 19 listed below had 46 per cent. The Swiss Hapimag and the US Sunterra's European operations are far larger than all their rivals.

Although only partial data are available on the number of units that each player offers, Hapimag has 5,500 units, Holiday Property Bond and Resort Properties both have just over 1,000 units, with Marriott Vacation Club International offering 768 villas and claiming 17,645 owners. In terms of the number of owners per unit, Hapimag has 25, Holiday Property Bond 33, Resort Properties 30 and MVCI 23, giving an indication of typical intervals purchased in each case and also of the variation that exists between companies. By inference from the preceding table, Sunterra in Europe might have of the order of 4,000 units and Club La Costa around half that number, although these figures are speculative.

European timeshare in brief

Some corporate players

- **Anfi del Mar** is a long established operator of timeshare resorts in Europe. It has four establishments in the Canary Islands in Spain. The company is currently focusing on its existing operations, expanding its capacity at its developments in the south of Gran Canaria, but notes that it would not rule out further development elsewhere in the future
- **De Vere Resort Ownership**, a subsidiary of De Vere Hotels of the UK, has three timeshare resorts in operation in Scotland and a fourth under construction. At present their market is predominantly domestic. The company, which pursues mixed use developments, has just signed its first foreign management contract for a resort in Spain, at which timeshare facilities will be available. It also has planning applications in for two new timeshare developments at existing De Vere hotel sites in the UK and is considering further developments of this nature
- **GH International**, a joint venture between Grand Heritage Hotel Group of the US and Great Hotels Organisation based in the UK, (with a fund of US$100mn to develop hotel management and investment portfolios in Europe and China), is one of the first operators in Europe to embark on a multi-country development of fractional interest and PRC resorts. The company expects to announce its first three projects shortly and plans to have ten residence club projects completed by 2010. These will involve a mixture of urban and resort properties with an initial focus on London, Paris, Marbella and the Algarve. The company sees small, unbranded, developments in existing hotels as particularly appropriate for this upper end of the market niche.
- **Hapimag**, a Swiss company, is Europe's largest timeshare owner/manager with 5,500 units, of which over 90 per cent are in Europe. The company's largest concentrations of resorts are in Germany (1,137 units), Spain (690), Turkey (623) and Austria (518). Hapimag's modus operandi is that customers purchase shares in the company which entitle them to access to any of Hapimag's resorts.
- **Hilton International Grand Vacation Company (HIGVC)** is the timeshare arm of the UK-based Hilton International. At present HIGVC has just three timeshare resorts, all of which are in Scotland, but is opening a fourth in Ireland at the end of 2005 and a fifth in Portugal in 2007 (plus two more which are under construction in Egypt). To date their market has been almost entirely domestic in the UK, although this is expected to change slightly as the new properties become available.
- **MacDonald Hotels**, the UK hotel operator, entered the timeshare industry through the acquisition, in a deal completed in 1997, of Barratt International Resorts, which had been one of Europe's largest combined timeshare owners and operators. The group has a total of ten resorts, with four in Scotland, one in the south of England, one in Snowdonia in Wales, and four in Spain. Although hotel operations are MacDonald's core business, the company stresses the benefits of the synergy of the mixed-use model. The company sells fixed week inventory in perpetuity as well as operating a points-based Vacation Club.
- **Marriott Vacation Club International (MVCI)**, one of the main players in the timeshare industry in the US, has five timeshare developments in Europe. With one of the first branded fractional operations in the region – a 49-unit townhouse conversion in central London (selling at between £85,000 to £202,000 for a 28 day entitlement each year to 2050) – it is being closely watched by the industry. Despite the company's professed interest in the market, Europe has yet to see one of its more up-market Ritz-Carlton timeshare resorts.
- **Sol Melia**, Spain's No 1 hotel group, is entering the timeshare business in Europe for the first time. Industry observers hail the entrance of a large Spanish branded hotel group as a big step forward for the industry. Sol Melia Vacation Club has three projects underway – in the Costa del Sol, Majorca and the Canary Islands, with another two in the pipeline. The company indicates that it sees hotel developments of the future encompassing a variety of operations which might include timeshare, fractional and condos, all on the same site.
- **Sunterra Europe**, a subsidiary of a US parent, has 34 resorts in Europe of which almost half are in Spain. Almost 90 per cent of Sunterra Europe's clients are in the UK, the market on which the company is primarily concentrating before it launches major initiatives in other European markets.

The exchange companies

- **RCI** is the world's largest exchange company with properties in all regions of the world and 450,00 members in Europe. Whilst acknowledging that growth in Europe has not been as fast as in the US, RCI is of the view that relative to the growth of travel and tourism in Europe, timeshare in the region is holding up well. More importantly, the prospects are good with the sector evolving to attract new markets and new entrants. RCI's new Registry Collection, for example, has been introduced to cater for the new niche fractional interests at the top end of the market.
- **Interval International (II)** is the other principal exchange organisation and is approximately one third of the size of RCI in terms of membership. II is of the view that timeshare in Europe lags behind the industry in the USA due to uneven regulatory environments across Europe, a tendency to over-regulate in some countries and also because, to generalise, quality has not been as high in Europe. Nonetheless, II believes that timeshare potential remains high in Europe and that urban products are likely to become increasingly popular alongside the traditional beach locations.

Other relevant organisations

- **The Organisation for Timeshare in Europe (OTE)** is the trade's main representative body. It is based in Brussels, but its membership excludes a number of the major players and companies. Its role embraces lobbying on behalf of the industry and the establishment of operating standards. OTE regards the potential for timeshare as likely to be enhanced by the arrival of the major branded companies, and that this will inevitably promote industry consolidation. OTE also believes that the uneven regulatory environment in different countries is not conducive to promoting growth.
- **The Timeshare Consumers' Association (TCA)** is based in the UK and represents timeshare owners. It involves itself in dispute resolution and also carries out research into the sector. The TCA expresses the view that the industry is still plagued by rogue operators – primarily those who operate travel clubs rather than timeshare per se, but a distinction recognised neither by the media nor the consumer – and that much still needs to be done to clean up the sector.

Key issues

Branding

Branding has to date not been a feature of the timeshare industry in Europe to the same extent as in the US. This partly relates to the sector's lifecycle (generally regarded to be some 5-10 years behind America), in which the industry's early developers evolved out of a real estate rather than a hospitality background. A number of smaller European hotel companies such as MacDonald and De Vere have been active in the industry for some years but the major international, US-based hotel companies have been slow to enter Europe. Major players in the US timeshare sector, such as Starwood and Disney, have no representation in Europe's timeshare industry to date, while Marriott has just five resorts and Hilton, through the UK-based Hilton International, has just three resorts in Scotland, with two more opening in Ireland and Portugal by 2007. Generally, the most important brands in Europe to date have been the two major exchange companies, RCI and Interval International, rather than hospitality companies per se.

This situation is beginning to change with the arrival or expansion of well-recognised groups like Marriott (MVCI) and Hilton (HIGVC) (although the major hotel companies are still very much a minority and the case for major expansion in Europe has still to be made). At the same time, there appears to be the beginnings of more serious interest from home-grown groups. Sol Melia, Spain's largest group which already has timeshare operations in the Caribbean, is about to venture into the European market later this year and groups such as Pestana and Grecotel are raising their game.

This is a significant rite of passage for the industry and the growth of branded timeshare properties is likely to have an increasing impact on the sector as a whole. Recognised brand names, analysts argue, help to raise the status of the industry, providing it with a respectability that has until now been one of its stumbling blocks. Hotel companies make it easy for people to visit and inspect sites and do not use high pressure sales techniques. In addition, quality hotel groups that have high brand recognition are able to generate a trust and confidence among consumers and potential consumers that independent operators find more difficult to achieve. Purchasing a branded property provides the consumer with the belief that his/her investment is secure, that the company has the necessary know-how and knowledge to look after it, that the property will be properly maintained, and that the timeshare can be re-sold, probably at a premium.

This is important in helping to move the industry forwards and at the same time will assist in bringing marketing and sales costs down. Loyalty has proved itself a key component of growth with companies such as Marriott, through the linkages between hotel and timeshare and through the flexibility offered by rewards programmes. MVCI notes that across the whole group some 50 per cent of its business comes from the company's own customers and that they brought in US$75m business in 2004.

Timeshare regulation

Most members of the industry interviewed for this study identified the legal and regulatory framework surrounding timeshare sales in Europe as a key influence on the sector. While most agreed that regulation has improved consumers' confidence in a sector where sales techniques had caused a lot of damage, some also felt that the current legislative framework errs too much in favour of the consumer. On the other hand, companies such as the Spanish group, Anfi and Sunterra Europe (see table on opposite page), expressed the view that for professional operations, the Directive has had no adverse effect on business as most of the high end timeshare companies work with their own internal code of ethics which are designed to offer a good product sold in a no-pressure environment.

The European Union's Timeshare Directive was passed, in response to a variety of concerns, in 1994 for implementation in 1997. In essence, this encompassed four key provisions:

- the introduction of a statutory minimum cooling off period of 10 days after the signature of the contract to purchase by vendor and purchaser;
- a ban on the taking of deposits until the end of the cooling off period;
- a requirement that contracts should be in the language of the purchaser's country of residence; and
- the requirement that a full description of the property and the purchaser's right be provided as part of the contract.

While the industry was in broad agreement that better legislation was required, at the same time, the Directive continues to provide scope for rogue operators to bypass the regulations by introducing travel clubs which sell travel packs which are not supported by inventory, and by allowing uncontrolled marketing and sales practices to continue. These are still regarded as "timeshare" by the consumer – and frequently the media too – and this has helped to perpetuate the sector's tarnished image.

Furthermore, the incorporation of the Directive into national laws (only completed in September 1999) has resulted in an uneven spread of measures in individual countries. Across the participating countries, cooling off periods vary between 10 and 15 days but, most importantly, there is a lack of consistency regarding deposit taking. Of the 16 countries that initially signed up to the Directive (including some non-EU members), six imposed an absolute ban on deposit-taking while nine appear to allow deposits to be paid either to third parties or escrow account holders, but not to vendors or credit agents funding the purchase. Because of this variation, timeshare development is easier in some countries than in others. In France and Portugal, for example, it is reported that new developments have all but come to a standstill as a result of the national legislation.

Thus the Directive has had a dual effect, assisting growth by helping to stamp out some of the worst excesses of former years and thus improving the sector's image, while at the same time hampering it by its unbalanced regulations and lack of consistency throughout Europe. Operators argue for more balanced legislation which provides greater clarity and has common applicability across Europe, often quoting the stronger and more consistent regulations in the USA as providing the required environment for timeshare in Europe to reach what they see as its full potential.

Sales and marketing

Sales and marketing practices have been a thorn in the side of the timeshare sector since the outset. Unscrupulous developers employing dubious methods did immeasurable damage to the industry's image and were in large part responsible for the Timeshare Directive. This poor image has been mitigated through the methods of the mainstream companies but the legacy still lingers (and is in part perpetuated by the activities of the travel clubs) and means that developing relationships and sales leads is still a major issue for them. Sales and marketing costs for the various range of timeshare products run at between some 30 per cent and 50 per cent of costs.

Sales and marketing methods are now becoming much more targeted and sophisticated and companies are working hard to bring costs down. Anfi, for example, notes the importance of developing good business to business relationships for lead generation; links with credit card companies, car dealerships and other high profile business relations (together with the entry of well known hotel chains as discussed) has lifted consumers' perception of the industry. Other timeshare developers are successfully using mini-vacations to trial products (as in the US) and De Vere, for example, is using holiday letting as a no-pressure method of attracting customers to its timeshare units. Other changes include the increased use of the Internet by prospective purchasers which means that they are already well informed when they visit a property.

The industry's new shape

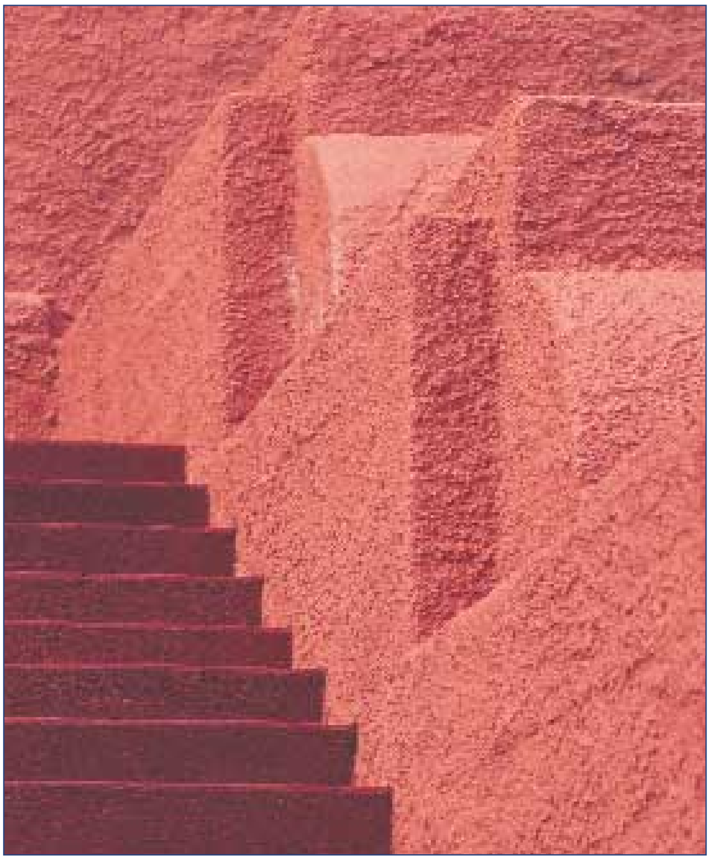
With the expansion of the branded operators, the introduction of new models and the increasing focus on mixed-use developments, the shape of the industry is changing. Development of the classic timeshare model aimed at the blue collar worker is reported to be static or is showing only slow growth for a number of reasons: the initial market has become more affluent, the low cost airlines have introduced a new dimension, and people are now demanding higher quality. Also, as Paul Dean of Dean Associates points out, early timeshare developments often involved the acquisition and conversion of distressed hotel stock. While this was adequate at the time, consumers' tastes have moved on and such inventory can no longer satisfy the market's demand for higher quality.

While new models such as fractional sales, private residence clubs and other derivatives are still very much in their infancy in Europe – and in reality very few are up and running – this nevertheless appears to be where there is greatest interest and where growth is happening. Worldwide, MVCI predicts the ratio of timeshare/fractional sales to move from 84:16 in 2004 to 74:26 in 2008. However, these newer models are likely by their nature always to represent a minority of sales since they tend to be niche, more exclusive properties which cater to a small group at the upper end of the income bracket.

Flexibility – originally offered simply through the exchange schemes of RCI and Interval International – is now more diversified, widespread and provided through a variety of ways. It has also become an essential component of the modern timeshare offering, whether it is in the form of:

- points with which consumers can buy a variety of leisure options such as plane tickets, car hire or private jet;
- holiday durations enabling consumers to take one week holidays or longer, or short breaks;
- exchange schemes and multi-destination companies which offer all types of destination in terms of urban properties, ski destinations, beach holidays and so on, as well as domestic, short haul and long haul destinations;
- floating or fixed weeks;
- on-site mixed use developments, such as with a hotel or an activity centre; and
- a variety of types of real estate and right-to-use investments that can be made.

As the UK hotel group MacDonald Hotels notes, timeshare has now become a "lifestyle product" providing a whole range of travel purchases for which flexibility is the key. Thus the timeshare industry of 2005 and beyond is working to provide the variety that changing holiday patterns demand, as well as a product that increases profitability, and the timeshare purchaser will be using his investment as an exchange tool for a lifestyle product.



Financial and economic aspects

The underlying rationale

Pure timeshare companies, as opposed to hotel companies with timeshare interests, find it very difficult to raise development finance. Analysts note that financiers are very reluctant to lend to timeshare projects due to the sector's poor image, a lack of transparency in accounting procedures, very high sales and marketing costs and a generally poor understanding of the industry. Loan funds are much more likely to be available to companies, such as hotel operators, with a different core business, the ability to develop sales leads from existing customer databases and an established relationship with bankers.

Nonetheless, research carried out for this study confirms that timeshare projects can generate a higher rate of return than standard hotel developments – although of course the main revenues from timeshare typically only endure for a few years during the interval sales phase. From the investor's point of view therefore, the financial payback can be attractive and relatively immediate.

The branded hotel chains, whose entry into Europe's timeshare sector is beginning to be more apparent and whose stamp of respectability may prove to be the key to the sector's future, have another, wider agenda. In some cases, a timeshare development on the same site as, or at least adjacent to, an existing hotel and/or resort, has important potential benefits for the hotel. This arises in several areas (see remarks on Marriott below), but affects two in particular. Food and beverage sales in the hotel can receive a substantial boost, usually at low marginal cost, from demand generated by timeshare owners in on-site properties. One branded hotel in Scotland of less than 100 rooms states that the hotel's F&B sales to timeshare owners adds over £2m a year to F&B turnover. The same hotel also reports evidence of a second important benefit, that of enabling more extensive leisure, sports and/or health facilities to be installed on-site than the hotel itself could justify, again because of demand from timeshare owners.

Whether these effects are called levered sales, sweating the assets, or whether they simply demonstrate that substantial scale economies can be generated by adding additional demand at relatively low marginal cost, timeshare can bring these effects to an established hotel. Sol Melia Vacation Club is quoted as saying that in future, it believes that hotels could routinely encompass condominium, hotel, interval ownership, leisure and sports facilities and so on, all on the same site – or in other words, that the established hotel business model is changing in favour of mixed use developments. No longer will a hotel be restricted to its "normal" hotel functions, but will become increasingly a mixed-use site built around the provision of common, usually leisure services. This trend is already visible today in the expansion of extensive spa facilities at many hotels, partly supported financially by inviting club membership from the local community in addition to usage rights accorded to hotel guests.

Table 5: Marriott International's timeshare range and characteristics			
	Share of contract sales in 2004 (per cent)	**Average price**	**Typical customer**
Marriott Vacation Club International	81	$10,000-$60,000 for a week	$75,000-$200,00 household income
Ritz-Carlton Club	14	$150,000-$400,000 for 21-28 days	$200,000+ household income & $3 mn+ net worth
Horizons by Marriott Vacation Club	3	$8,000-$18,000 for a week	$50,000-$90,000 household income; value-conscious
Grand Residence Club	2	$120,000-$350,000 for a fraction	$175,000 household income and $1mn + net worth

Source: Presentation by Marriott International Inc, June 2005

Marriott Vacation Club International

Some of these points are well-illustrated by the experience of the major US-based hotel chain, Marriott International Inc.

One of the largest of the internationally branded players in the timeshare sector, Marriott offers four types of timeshare product – two of which account for 95 per cent of its global timeshare contract sales. Most of these resorts and sales take place in the USA rather than Europe, but the various types provide a useful guide to the underlying marketing philosophy. These are as above.

In essence, Marriott Vacation Club International (MVCI) properties are designed as traditional timeshare developments, while Ritz Carlton Club is based on fractional ownership. (Of MVCI's five European properties, four are timeshare and just one – an urban property in London – is based on fractional ownership).

The table below indicates some of the underlying features and differences between the standard timeshare product, as represented by the MVCI product, and the up-market alternative as represented by the Ritz Carlton Club.

From the standpoint of the investor/developer, it is clear that, on paper at least, the up-market fractional ownership model is the more attractive of the two, returning around 25 per cent as a development margin against timeshare's 17 per cent. Perhaps more striking is the difference in sales and marketing costs, with traditional timeshare developments requiring 43 per cent of the sales price to be devoted to this aspect of the investment, while fractional developments require little more than half as much. (PricewaterhouseCooper's own study for the American Resort Developers' Association – ARDA – in 2004 showed sales and marketing costs to have been in the range 47 - 48 per cent in 2001-2003, with general and administrative costs averaging close to 9 per cent.)

In common with all large hospitality companies, the benefits of timeshare projects to Marriott often include the ability to generate additional revenues from associated parts of their hotel business that are not directly part of the timeshare project itself. The company states that these include:

Table 6: Typical project structures for timeshare investments by Marriott		
	Marriott Vacation Club International	**Ritz Carlton Club**
No. of units/keys	300-500	40-80
Sales life	7-10 years	6-8 years
Project life sales	$300-500 mn	$140-200 mn
Project costs		
marketing & sales	43 per cent of sales price	22 per cent of sales price
product costs	40 per cent of sales price	53 per cent of sales price
development margin	17 per cent of sales price	25 per cent of sales price

Source: Presentation by Marriott International Inc., June 2005

- raising brand loyalty as measured by the average number of roomnights purchased in a Marriott hotel by a timeshare interval owner;
- raising the value of the Marriott rewards programme by increasing the range of desirable redemption locations;
- the generation of additional food and beverage revenues where a timeshare development is physically located alongside a Marriott hotel, where interval owners use the F&B facilities of the hotel; and
- creating value by leveraging the Marriott brand, increasing the customer base and providing additional outlets for Marriott's hospitality and development know-how.

For a major hotel company therefore, timeshare is seen as complementing the core business as well as being profitable in its own right (Marriott's profits from timeshare rose from US$123m in 1999 to US$203m in 2004, with the company predicting an annual 17 - 19 per cent rate of growth in timeshare profits in 2004-2008).

Typical US financial profile

An indication of the financial performance of timeshare investments in a US context from the developer's standpoint is available from Bear Stearns US Lodging – Timeshare dated May 2005. Based on a series of assumptions that reflect the approach adopted by the "Big Three" (Hilton Hotels Corp., Marriott International and Starwood Hotels & Resorts Worldwide), Bear Stearns states that these companies "can achieve 20 per cent levered internal rate of return on a typical timeshare project". The revenue streams included in the Bear Stearns analysis include income from the developers' consumer financing role, as well as the cash flow generated by the management of the resort (through maintenance and operating fee income), in addition to interval sales themselves which make up the great bulk of project income.

An example of the financial illustrations applied under the Bear Stearns analysis is shown in the following table:

The example below shows an internal rate of return well in excess of 20 per cent. It is noticeable that the proportion of total costs devoted to sales and marketing is, perhaps surprisingly, 54.8 per cent, higher than the typical example given for MVCI's standard timeshare project and in PricewaterhouseCooper's own study for the American Resort Development Association (ARDA).

Table 7: "Big Three" typical financial profile from a timeshare development project[a] (US$ mn)

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Revenues							
interval sales	5.9	26.7	31.5	28.0	34.3	29.7	26.9
consumer financing (net)	-	0.4	0.9	1.4	1.6	1.9	3.1
management (free cash flow)	-	-	-	0.1	0.1	0.1	1.4
Total revenues	**5.9**	**27.1**	**32.4**	**29.5**	**36.0**	**31.7**	**31.4**
Costs							
planning, land and building	-26.6	-	-15.9	-	-15.9	-	-
sales and marketing	-10.5	-12.8	-13.3	-12.9	-13.6	-13.1	-6.1
general administration, other	-1.3	-1.5	-1.3	-1.4	-1.3	-1.4	-1.3
Total costs	**-38.4**	**-14.3**	**-30.5**	**-14.3**	**-30.8**	**-14.5**	**-7.4**
Net cash flow	-32.5	12.8	1.9	15.2	5.2	17.2	24.0

Note: [a] Based on a three-phase development of 150 units selling 51 weekly intervals, with building taking place in Years 1, 3 and 5 for the three phases
Source: US Lodging – Timeshare, Bear Stearns, May 2005

Future prospects

The shape of the timeshare industry is changing, with segmentation a key influence. While analysts and practitioners broadly agree that the old-style, mass market product is static at best (and some consider it to be firmly in decline), demand for higher-quality, branded products and the new model of fractional ownership is reported to be strong. The consequence of these trends, however, is that volume growth is likely to be more difficult to achieve; if the product progressively moves up-market, then fewer people will fall into the target category. The former chairman of the Organisation for Timeshare in Europe (OTE), Ron Haylock summarises the view of many by saying that the timeshare market will grow steadily rather than rapidly in future in the light of these changes. Generally, growth broadly in line with overall travel and tourism growth rates is expected by many in the industry over the next few years.

It is to be expected that the branded hotel groups, particularly the European regional or national companies, will be increasingly attracted into the business, as is already evidenced by recent developments. Many hotel companies have changed their position from regarding timeshare as a threatening competitor to looking at timeshare as an increasingly attractive means of raising additional revenues and of "sweating their assets" more effectively.

The OTE feels that industry consolidation, which has already taken place among some of the early developers, will inevitably occur, with the high-quality assets of smaller, specialised operators likely to become targets for purchase by the larger groups, including the hotel companies. OTE predicts that consolidation will in due course lead to a premier league of perhaps only 15 key operators who will control 80 per cent of capacity in Europe. Should this be proved correct and be accompanied by a more prominent role played by branded international hotel companies, the attitude of financiers might also be expected to change with the consequence that higher-quality resort development, attended by more open and straightforward sales and accounting practices, is likely to raise the sector's reputation among both financiers and consumers.

From the market demand point of view, the essence of the sector will increasingly be that of flexibility of use, not only in terms of exchanging intervals in other properties but also in terms of using the points or credits gained by interval ownership for other travel products and services. In this context the points/credits begin to act as a type of holiday currency with which the consumer can buy a variety of services related to their leisure needs and preferences. Again, with greater consumer interest and confidence, the attention of the investor is likely to quicken.

In summary, timeshare in Europe has not proved to be the blockbuster sector predicted 10-15 years ago. However, the industry, backed up by better regulation, better quality operators and a more experienced and better-informed public clearly has a role to play in leisure development, and is also capable of providing investors with good, even exceptional, returns in the right circumstances.

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Research method

This study was researched for Hospitality Directions by Travel Research International Ltd. It involved wide-ranging discussions with a representative selection of timeshare developers, operators, industry groups and analysts. We gratefully acknowledge the assistance of those whose names and organisations are given at the end of this report. In addition to this primary research, an extensive range of relevant published material was collected and analysed.

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