THE SHARING ECONOMY

- *its relevance to Holiday Accommodation in China*

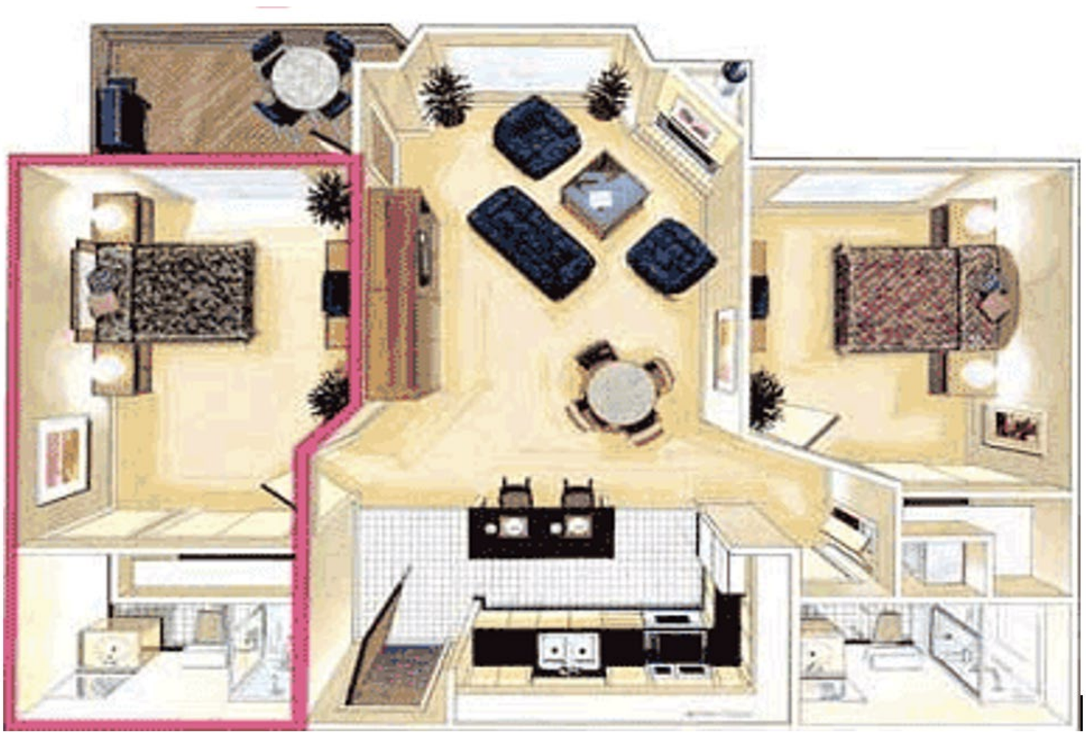
1. SHARED OWNERSHIP of Holiday Accommodation

Given the range of shared ownership products which have appeared in the mature markets of Australia, Europe, Japan, Mexico, North America, South Africa and elsewhere it is helpful to review these concepts and products so that they are properly understood, as they continue to evolve.

Timeshare or Vacation Ownership, as it is sometimes called, was one of the very earliest manifestations of the Sharing Economy when it first appeared in Europe back in the late 1960's. Typically, it comprises exclusive rights to use resort real estate, granted to a number of persons, all of whom are entitled to a similar right, for a specified period each year, over a period of years or sometimes in perpetuity.

This usage right may be linked with direct or indirect beneficial ownership of the real estate by those persons entitled to the right to use, as is commonly the case in the USA. The right to use is granted in consideration of an initial purchase price, coupled with an obligation to contribute annually to the maintenance and operating costs of the resort and its amenities.

What about the physical product? Timeshare accommodations in western markets have tended to be significantly different to traditional hotel accommodation. They are usually much larger, self-contained units of one, two or even 3-bedroom configuration, often including a full kitchen, one or more bathrooms and spacious living areas. These differences are illustrated in the specimen floorplan below:



From an economic perspective, timeshare has always been positioned as a leisure or holiday product, rather than an investment, where buyers' motivations to purchase include:

- The ability to save money on future holiday accommodation costs when comparing the cost of purchasing the timeshare interest with the annual cost of renting similar quality accommodation.;
- The certainty of being able to access consistently high-quality timeshare accommodations, especially when developed, sold and managed by a recognised hospitality brand;
- The ability to exchange annual usage entitlements for space at other quality resorts around the world, primarily through affiliation with one of the leading global exchange companies;
- Opportunities to mix with like-minded people and create new friendships.

2. HOW ARE SHARED OWNERSHIP PRODUCTS TYPICALLY STRUCTURED?

Depending upon the jurisdiction in which the development is located, there are many ways of establishing shared ownership offerings. However, in general two basic legal approaches are used:

(a) based upon the jurisdiction's real estate laws; and

(b) based upon applicable contract law.

Uniquely, in Australia, timeshare is structured and regulated as a "managed Investment scheme" and is subject to scrutiny by ASIC, making it the toughest regulatory environment on the planet.

In various jurisdictions this distinction is critical in deciding how

(i) the creation and sale of the shared ownership right is to be treated for tax purposes; and

(ii) the ownership of "the right to use" in respect of the real estate, is secured or otherwise fully protected in the event of the insolvency or bankruptcy of the developer.

3. THE VARIOUS CATEGORIES OF SHARED OWNERSHIP

a. Timeshare

The Timeshare product has historically been structured in a variety of different ways, depending upon the jurisdiction in which the projects are located. Within the USA market, timeshare interests have usually comprised a right to the use of vacation accommodation, linked to a deeded real estate interest, which usually runs in perpetuity. This format is largely driven by Generally Accepted Accounting Principles within the United States [often referred to as "US GAAP"].

In Europe and elsewhere, timeshare is more often structured as a "right to use" which typically entitles owners 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.

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 are the essential "fuel" to run the resort's management operations.

Some timeshare products are fixed time (e.g. the owner has the 34th week of the year in each year). Many timeshare products are floating time programs, where the occupancy rights will "float" within a defined Season, requiring the owner to make an annual reservation. Most timeshare resorts are affiliated with a major exchange company, such as Interval International or RCI.

b. 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. Major USA developers, such as Marriott, Hilton, Wyndham and Disney operate Vacation Clubs.

Most, though not all, Vacation Clubs adopt "holiday 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. Vacation Clubs offer consumers the ultimate in flexible vacation options and related privileges.

For example, Hilton Grand Vacations Company, Marriott Vacation Club International and Wyndham Vacation Resorts 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.

c. 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 1/8 and 1/4 ownership, giving the Fractional Owner between 6 and 13 weeks of use per year. Fractional products are often sold using a deeded ownership structure.

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. Fractional owners regard this interest as an investment, as well as a lifestyle enhancement, rather than simply a holiday product. The fractional ownership concept has also been applied to personal property such as boats, yachts, supercars, racehorses, designer handbags and works of art.

d. Private Residence Clubs

Private Residence Clubs are in the upper end of the market of Fractional products. Private Residence Clubs are distinguished from other forms of Fractional products by the extensive overlay of guest services, amenities 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 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 high annual maintenance fees and in some cases a daily use fee. They will usually represent the pinnacle of quality in both accommodations and amenities and are truly "five-star" in every respect. Developers and Operators in this segment include Ritz-Carlton, St Regis, Fairmont, Four Seasons and Hyatt.

4. OPPORTUNITIES for Shared Ownership of Holiday Accommodation in CHINA

The exponential growth of China’s domestic travel market has been well documented in recent years, in parallel with the growth of Chinese outbound travel. China's domestic tourism industry earned ¥4.57 trillion yuan (USD $720 billion) with 5 billion domestic trips made in 2017, up 15.9 percent and 12.8 percent, respectively, according to the China National Tourism Administration (“CNTA”). Of the 5 billion domestic trips made in 2017, half of those trips were made within rural China. The industry contributed ¥9.13 trillion yuan to China's GDP, accounting for 11 percent of economic output, according to preliminary statistics. As the world's largest source of outbound tourists, China saw 130.5 million overseas trips made in 2017, an increase of 7 percent from the previous year.

This growth bodes well for the domestic hospitality industry especially considering the wider “consumption upgrade” that has been evident in recent years as China’s consumer tastes and demands evolve in step with rapidly rising affluence levels. This is especially evident within the travel and lodging sectors where domestic travellers are seeking better quality accommodations and experiences than they were a decade ago.

These trends provide new opportunities for Real Estate Developers who are prepared to embrace the Sharing Economy to monetize their real estate. Instead of selling the real estate, Developers can adopt innovative membership programs which offer flexible annual usage of high quality properties and can also provide other travel-related membership benefits. This approach to the monetizing of holiday homes and recreational real estate has become well-established in western markets. Whilst the western model is not the best solution for China, it provides some useful pointers as to how new products which will resonate well with affluent domestic travellers.

This is also much more relevant today in the light of restrictions imposed by the Central and Provincial Governments to second home purchases in various parts of china to curb property speculation.

In April 2018, Beijing imposed restrictions on the purchase of property in Hainan, about a week after it announced an ambitious free-trade zone plan for the island, which is also known as "China's Hawaii". In a move that suggests zero tolerance for speculation, the provincial government has stipulated that non-locals cannot buy homes in Hainan unless they can provide official proof that they have paid the local social security fund for 24 months. In the hotspot cities of Haikou, Sanya and Qionghai, buyers must prove they have paid social security for 60 months. In the central mountainous region, non-local buyers are banned altogether.

The latest restrictions updated a March 31 rule that allowed non-locals to buy one apartment. The new rules also stipulate that non-locals cannot borrow more than 30 per cent of the value of a property from banks, and after purchase the homes cannot be sold within five years.

The creation of short to medium term Membership Products entitling Buyers to exercise flexible rights of use, occupancy and enjoyment for leisure purposes, may provide an elegant solution for Developers who are thinking about what to do next with holiday or resort properties which are already built and completed, but which they may struggle to sell outright.

5. Some reflection to the current China practice

Needless to say, Chinese customers have been a major source of timeshare buyers in the Asia Pacific Region, where international brand such as Wyndham, Marriott Vacation Club, Anantara, etc. have all been actively engaging themselves in. Domestic players from various spectrums are trying to catching up as well—some are developers who want to upgrade traditional ways of real estate development, and some are conglomerates who seek synergy among their various portfolios in the wave of consumption trade-up. Shared Ownership is not a must-go option but appears to be a proved business model worth trying. However, doing this is not without challenge in China.

Some adaptations to the traditional shared ownership have seen in the product term, sales price and annual maintenance fee. Domestic products usually tend to choose a shorter term, such as 5 to 10 years, so to market the product at a more affordable price and differentiate it from an assets investment. As a result, the targeted market segment might be more sensitive to the price itself, while overlooking the value of a hotel brand and exchange platform vested in a product. To save the trouble in convincing potential buyers to agree on the annually fee, developers will try to have it inclusive in the package price, which sometimes might sacrifice the lifestyle part of the product eventually.

These may all be good ideas until a couple of questions are well identified and rightly answered. Has the product been targeted to the right market in terms of its pricing and standard of accommodation and services? How the sustainability of the project operation can be ensured if annually fee is concluded in the price package? Has an affiliated exchange company been in place to provide flexibility of accommodation or the developer itself has a plan to create an exchange platform?

There are other issues, such as legal structuring and consumer protection, might also be very China specific. That being said, the international practice over the last 40 or 50 years will definitely contribute to set the course of what the future of China's Shared Ownership may hold.