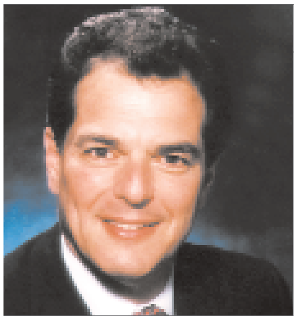

By Rick Swig

Despite Lack of Long-Term Data, Developers Favor Hybrid Projects

IN 2005, FRACTIONAL, CONDOMINIUM AND residential inclusions are becoming a typical part of any hotel development. Almost any new hotel project includes one of the aforementioned components to justify and support the viability of the project.

There are fundamental methods to measure demand, positioning opportunities and revenue potential for traditional lodging projects to confirm or deny the feasibility of a hotel development or acquisition for potential owners. Additionally, there is further public information available to identify incremental revenue possibilities and expense margins for forecasting purposes.

Quantifiable forecasts for hybrid hospitality projects are simply not as clear, since many seem to be based on concept and aspiration versus historical data. Research indicates that there is consumer desire to own a second home as a real estate investment with the combination of consistent yield, appreciation and value-added opportunities. The prescription may be a condominium, which can yield financial returns as part of a hotel's inventory, or a fractional ownership location, which provides a vacation home option without the upkeep headaches. Common sense and wishful thinking validate these directions, but where is the reality check?

Nearly half a million people invested in vacation property in 2003, which was up 24% from 2001. (New statistics are expected to show a similar pattern for 2004.) This was during a similar period when traditional hotel occupancies and room rates were declining. At the same time, worldwide sales of high-end fractional ownership and non-equity residence clubs rose to $515 million, which was a one-year increase of 38%. With upscale fractional investments ranging from $50,000 to $1 million per unit or share, there seems to be a market for consumers, who are now known as the "rational rich," to invest in the ownership rights of two weeks a year instead of traditional year-round ownership complete with the headaches of perpetual upkeep.

This formula, although meeting with some success, is not a proven solution to development prosperity.

At the same time, some hotel companies are purposely including fractional and condominium components as a development tool because it is a perceived way of paying off initial development costs and turning a profit more quickly. This formula, although meeting with some success, is not a proven long-term solution to development prosperity.

From the point of view of both a consumer and developer, however, the new condo, residence club or fractional ownership structure might not be the panacea. Consumers are now experiencing surprise from double-digit increases in periodic maintenance fees. Soon there will be the potential for large incremental investment surcharges resulting from hotel brand requirements for product standards and maintenance of the physical plant quality due to typical wear and tear. In addition, the resale value of fractional and condominium ownerships in the new wave of development remains largely unproven.

Developers are faced with the consequences of consumer market depth. Beaches, lakes and mountains have been the foundation of second-home ownership, so what of the urban development of non-traditional, mixed-use, hotel-residential projects? Although in 2003, fractional ownership grew 120% in sales volume (2004 is expected to exhibit a similar trend), the product base is still limited, while the potential depth of demand has not been fully quantified. Abundance of inventory that has historically been the Achilles' heel of traditional hotels will impact this hotel business as well.

Fractional and condominium hotel development is aimed at providing incidental overnight stay demand with an alternative option. This will have impact on demand for traditional hotel rooms. Again, there is no broad-based and long-term research to clarify the potential for displacement and financial impact on hotels.

The only sure thing in the evolution of alternative hospitality residence products is that it is new territory. The learning curve will certainly be long term and require at least a couple of product cycles. Fasten your seatbelts and get ready for the ride. ◆

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