



ANAHEIM  
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The Annual Conference of the Financial Planning Community

<b>TRACK:</b>	<b><i>SPECIAL ISSUES &amp; GLOBAL</i></b>
<b>SESSION: 979062</b>	<b>PURCHASE A TIME-SHARE INTERVAL OR RENT ROOMS?</b>
	TUESDAY, OCTOBER 13, 2009
	10:30 AM - 11:45 AM
<b>PRESENTER:</b>	Robert B. Larson, J.D.
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<b>PRESENTER:</b>	Stephen J. Larson, PhD, CFP®
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# Purchase a Time-Share Interval or Rent Hotel Rooms?

Preparing for a Discussion with Clients



Stephen J. Larson, Ph.D., CFP®

Robert B. Larson, JD

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## Outline

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|---------------------------|-----------------------------|
| 1. Objectives of Research | 5. Risk Considerations      |
| 2. Overview and History   | 6. Legal Aspects            |
| 3. Benefits to Developers | 7. Summary and Conclusion   |
| 4. Cash Flow Analysis     | 8. Questions and Discussion |

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## Objectives of Research

- Help financial planners prepare for discussions about time-share purchases
  - Facilitate successful client counseling
- Provide a ***non-biased*** paradigm

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## Authors' Motivation

- We attended a misleading and high pressured sales pitch
- Startled by lack of Financial Planning Literature



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## Overview and History

### Terminology

- Time-share resort
- Time-share unit
- Time-share interval
  - e.g. 7-Days
- Fixed time
- Floating time
  - Floating annual
  - Floating seasonal
- Points

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## Overview and History

- Exchange Programs
  - Resort Condominiums International (RCI)
  - Interval International
- Crotts and Ragatz (2002)
  - 83.1%--Exchange opportunity
  - 59.2%--Money saved
  - 14.8%--Investment

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## Overview and History

- SuperDévoluy, France
  - High Alps
  - Late 1960's



[http://www.desktoppicture.com/DPS/Places/FrenchAlps\\_1.html](http://www.desktoppicture.com/DPS/Places/FrenchAlps_1.html)

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## Overview and History

- 5,000 time-share resorts worldwide in 110 countries

**Location of Resorts**



Sparks, Butcher and Pan (2007)

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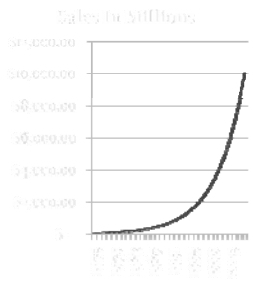
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## Overview and History

- Time-share interval sales grew from \$50m to \$10b between 1975 and 2006
- 18.64% annual growth

**Sales in \$Millions**



Powanga and Powanga (2008)

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**Overview and History**

Interval owners typically are:

- Affluent
- Well educated
- Baby boomers...

Sound familiar?

Crotts and Ragatz (2002)

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**Benefits to Developers**

- Multiple sources of income
- Recessionary risk transferred to interval owners
  - Time-share resorts, unlike hotels, are somewhat immune to economic cycles

Powanga and Powanga (2008)

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**Cash Flow Analysis**

- See Table 1 (handout)
- Comparison of vacation rental cash flows to time-share interval cash flows
- Present value analysis
- 5% opportunity cost rate

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## Cash Flow Analysis

### Input Variables

- 7-day interval
- \$200/night rental cost
- \$695 interval annual fee
- \$12,500 interval cost
- 10% down
- 7.2% finance rate
- 10 year repayment
- 33% marginal tax rate
- 43% of interval price is related to marketing cost
- 20% sales commission on resale in 20 years
- 3% across the board inflation

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## Cash Flow Analysis

### Main Points

1. Resale Value  

$$\$12,500 * (1-0.43) * 1.03^{20} * (1-0.20) = \$10,294.83$$
  - 43% of price of new time-share interval is related to marketing cost, Powanga and Powanga (2008)
  - 3% Inflation over 20 year holding period
  - Resale fee (commission) can be as high as 25%, Ziobrowski and Ziobrowski (1997)

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## Cash Flow Analysis

### Main Points

2. Amounts in interest tax deduction column are positive denoting cash inflows  
*\*Assumes home equity loan that qualifies for tax deduction*
3. No property tax deduction
4. Simple comparison of cash flows is not achievable

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## Cash Flow Analysis

### Main Points

5. Present value analysis with 5% opportunity cost rate
  - \*Vacation rental option, PV=\$22,350.70
  - \*Time-share option, PV=\$19,616.88
  - \*d=\$2,733.82 (PV cost of time-share is lower)
6. We have not yet considered risk

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## Risk Considerations

We borrow from Hovey (2002), but we classify risk into 3 stages:

1. Purchase Stage
2. Ownership Stage
3. Disposition Stage

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## Risk Considerations

### Vacation Rental Option – “Hotel”

- Can be likened to a series of 20 call options
  - No obligation to stay at a particular resort
  - No obligation to travel in any one year
  - Strike price is set annually by the client’s resort of choice
  - Annual premium is \$0.00

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**Risk Considerations**

**Inflation Risk**

- Across the board inflation increase, from 3% to 4%, improves the interval option
  - 100% of vacation rental's cost is negatively affected
  - For the interval, only the annual fee is negatively affected
  - The higher inflation rate on resale helps interval option
  - $d = \$4,586.06$  in favor of interval option

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**Risk Considerations**

**Interval Option Purchase Stage**

- Time-share resort is undersold
  - Impacts value of resort
  - Fewer owners share maintenance/management fees
- Possibly subjected to high-pressure sales tactics

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**Risk Considerations**

**Interval Option Ownership Stage**

- Increased level of stress
- Assessment risk
- Agency problems
- Recession risk
- Exchange program default
- Personal financial risk

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## Risk Considerations

### Interval Option Disposition Stage

- Loss in popularity of resort and/or location
- Recession risk
- Political risk
- Exchange rate risk

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## Risk Considerations

### Suggested Tasks for the Planner

- Create a spreadsheet
- Run various scenarios
  - Change inflation
  - Include an example assessment charge
  - Etc.
- Discuss risks

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## Making the Choice

- Refer to Table 1
- $d = \$2,733.82$  (in favor of the interval)
- Review risks with the client
- Client decides
  - It would be up to the client to determine whether this difference is adequate in light of the risks

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**Legal Aspects**

As always, financial planners should not give legal advice to clients. Refer any legal questions or issues to a barred attorney.

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**Legal Aspects**

Sources of Legal Rights

<p><b>State Statute</b></p> <ul style="list-style-type: none"> <li>• Provide legal protections</li> </ul>	<p><b>Contractual Rights</b></p> <ul style="list-style-type: none"> <li>• Covenant and restrictions provide contractual protections</li> </ul>
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**Legal Aspects**

State Statutes

- Cancellation period
  - Most states provide for a set number of days in which the interval purchaser may cancel the contract for sale without penalty
  - Attempts to waive this right are invalid and inoperable
- Signature block
  - Must include the cancellation period in **bold** and **CONSPICUOUS** print
  - Some must have specific wording provided by statute
- Generally, both primary and secondary sales are covered

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## Legal Aspects

- Number of cancellation days for states with large numbers of time-share resorts
- Financial planners should consult with an attorney to ensure these have not been amended

State	Right to Cancel Number of Days
Arizona	7
California	7
Colorado	5
Florida	10
Hawaii	7
Massachusetts	3
Missouri	5
North Carolina	5
Nevada	5
South Carolina	5
Texas	6
Wisconsin	5

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## Legal Aspects

### Covenant and Restrictions

- Document established by the developer that grants the interval owner exclusive right to possession during their time period
- Provides for positive and negative restrictions
- Check for right of first refusal in subsequent sale
- Client should review the covenant and restrictions prior to a purchase to ensure against unpleasant surprises

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## Legal Aspects

### Forms of Ownership

#### Fee Simple

- Ownership in real property
- May be disposed of by sale, gift or bequest
  - Right of first refusal may affect this
- Property is deeded, but the deed may be held by the developer-financier
- Time—grants exclusive possessory interest for a defined period annually

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**Legal Aspects**  
Forms of Ownership

Right to Use

- Does not carry a fee interest in property
- Contractual right for a specified period of year
- Transferability is often limited
- Three Types:
  - Vacation License
  - Vacation Lease
  - Club Membership (membership interest)

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**Legal Aspects**  
Forms of Ownership

Right to Use

Vacation License

- Grants the holder a right to an undesignated type of room at a specific resort at a particular time yearly
- Lasts the useful life of the resort
- May only be transferred with permission of the resort
  - If permission granted, may not be sold at a profit
- Generally found in functioning hotels

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**Legal Aspects**  
Forms of Ownership

Right to Use

Vacation Lease

- No interest in real property
- Holder is able to sell interest at a profit
- Has a right to occupy a specific unit for a specific time annually

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**Legal Aspects**  
Forms of Ownership  
Right to Use

Club Membership

- Similar to a country club
- Never saleable or assignable
- Use of an undesignated unit for a fixed period of years
- Usually a points based system

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**Legal Aspects**

- Clients should be aware of the time-share interval's form of ownership
- Consideration of legal and contractual risks should be reviewed when discussing financial risks
- Ownership form may have a dramatic impact on a client's decision to purchase

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**Summary**

- Our goal has been to provide a non-biased paradigm from which to base client discussions
- We hope more is written on this emerging financial planning topic
- Vacation planning could perhaps be incorporated into the 89 topics

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## Summary

### Main Points

1. 43% of the price of new time-share intervals may be attributed to marketing costs
2. Developers gain by selling intervals instead of running hotels [Risk transference]
3. Comparisons of intervals to vacation rentals should include a review of risks along with a cash flow analysis
4. Cancellation period can be a protective measure
5. Form of ownership and other legal issues should be reviewed with an attorney prior to purchase

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## Questions and Discussion

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Thank you

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