



**INDUSTRY OVERVIEW OF
LUXURY FRACTIONALS AND
PRIVATE RESIDENCE CLUBS**

APRIL 2005

By

HOBSON REAL ESTATE ADVISORS



RESORT AND HOSPITALITY

Forward thinking and strategic, we pride ourselves on market driven solutions to complex problems.

Explosive growth in the resort industry is anticipated over the next twenty years as baby boomers reach their peak earning years, as their children graduate from college creating more leisure time and disposable income, and as baby boomers receive their inheritance from the previous generation, the wealthiest in American history.

In the next decade, the resort industry will evolve rapidly to meet the needs of a growing and changing market. Trends toward complete master planned resort communities, the increasing importance of national name branding, and the emergence of new products like fractional shared ownership, called private residence clubs, will continue and accelerate.

Over the last decade, Hobson Real Estate Advisors has become an international practitioner in the resort industry with experience in North America, Europe, the Caribbean, and Latin and South America. We have become leading experts in one of the newest and most exciting product innovations, the fractional residence club, with the completion of more than 80 assignments throughout the world.

Marketing and Sales

[80 | 50 Private Residence Club](#)

Mammoth Lakes, California

[Rancho Valencia Resort](#)

Rancho Santa Fe, California

[Ritz Plaza Residence Club](#)

Miami Beach, Florida

Industry Studies

[US Fractional Industry Overview](#)

Hardin Capital, October 2000

Medalist Golf Development, June 2001

[European Fractional Industry Overview](#)

Four Seasons Residential Properties

[Caribbean Fractional Industry Overview](#)

Four Seasons Residential Properties

[Hawaiian Second Home Industry Overview](#)

Ko Olina Resort and Marina

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Fractional Residence Clubs

UNITED STATES

Arizona

Scottsdale

- *The Rocks*

Sedona

- *Sedona at Seven Canyons, Four Seasons Resorts*

California

Napa Valley

- *Hall Vineyards*
- *Calistoga Ranch, An Auberge Resort*

Indian Wells

- *Miramonte Club*

Rancho Santa Fe

- *Rancho Valencia Resort, Relais & Chateaux*

Santa Barbara

- *Ritz-Carlton Club*

Del Mar

- *Lowe Resorts*

Big Bear Lake

- *The Club at Big Bear Village*

Lake Tahoe

- *Tonopalo*

Mammoth Lakes

- *80/50 Private Residence Club*
- *Tallus*

La Jolla

- *Venezia Residence Club*

Newport Beach

- *St. Regis Residence Club at Dana Point*

San Francisco

- *Ritz-Carlton Residence Club*

Colorado

Aspen

- *Hyatt Grand Aspen*
- *The Residences at Little Nell*
- *Dancing Bear Lodge*
- *Charthouse Lodge*
- *Innsbruck Suites*

Red Feather Lakes

- *Fox Acres Resort*

Snowmass

- *The Timbers Club*
- *Snowmass Center*

Winter Park

- *Lodges at Jane Creek*
- *Vasquez Village*

Carbondale

- *Bair Chase Rod & Golf Club*

Basalt

- *Roaring Fork Club*

Telluride

- *Franz Klammer Lodge*

Connecticut

Westport

- *Inn at National Hall, Relais & Chateaux*

Florida

Miami

- *Williams Island Residence Club, Four Seasons Resorts*
- *Island Gardens, Watson Island*
- *Ritz Plaza Residence Club, South Beach*

Hawaii

Kailua-Kona, Big Island

- *Kahalu'u Beach Resort*
- *Mauna Loa Gardens*

Kahola-Kona Coast, Big Island

- *Four Seasons Resorts*
- *Mauna Lani Resort*

West Coast, Oahu

- *Ko Olina Resort and Marina*

Makena, Maui

- *Four Seasons Resorts*

Idaho

McCall

- *Hearthstone*

Sun Valley

- *Les Saisons*
- *Warm Springs*

New Mexico

Taos Residence Club

North Carolina

Pinehurst Residence Club

South Carolina

Charleston

- *Belvidere Club*
- *Lodge Alley Inn*

Vermont

Stowe

- *Lodge at Spruce Peak*

Windsor

- *The Ascutney Mountain Club*

Utah

Deer Valley

- *Deercreek Hotel and Club, a Rosewood Resort*
- *The Lodges at Deer Valley*
- *The Chateau at Silver Lake Sundance*
- *Resort at Sundance*

Wisconsin

Wisconsin Dells

- *Wilderness Resort*

Lake Geneva

- *Grand Geneva Resort*

CANADA

Invermere, BC

- *Klahowya Club*
- *Eagle Ranch Resort*

MEXICO

Cabos San Lucas

- *Las Ventanas Residence Club, Rosewood Hotels*
- *Esperanza*
- *Residence Club, Mega Terra*

Jalisco

- *Chamela Resort*

Nayarit

- *Los Tres Pueblos*

CARIBBEAN

The Bahamas

- *80/50 Emerald Bay*
- *Emerald Bay Residence Club, Four Seasons*
- *Discovery Bay*

Puerto Rico

- *San Miguel Resort Residence Club, Four Seasons*

Pinney's Beach, Nevis

- *Four Seasons Resort Residence Club*

Antigua-Barbuda

- *Jumby Bay Club*

St. Maarten

- *Isle de Sol*

St. Bartholomey

- *Isle de France*

St. John, USVI

- *Pond Bay Club*

Virgin Gorda, BVI

- *Bitter End Yacht Club*

OTHER LOCATIONS

Amsterdam, The Netherlands

- *ODE Fractional Residence Club*

Carmelo, Uruguay

- *Madison Resort Residence Club, Four Seasons*

Cote d'Azur, France

- *Terre Blanche Resort Residence Club, Four Seasons*

Viti Levu, Fiji

- *Taunovo Bay Resort, Rosewood Hotels*

Harrington Sound, Bermuda

- *Tucker's Point Club*

Costa Rica

- *Residence Club, Four Seasons*
- *Residence Club, Escape Properties*

New Zealand

- *Martinborough*
- *Lake Taupo*
- *Queensland*

RESORT AND HOSPITALITY, *page 3*

Master Planned Resorts and Resort Hotels

Anacortes, Washington
Resort Condominiums and
Timeshares
80 acres

Antigua-Barbuda*
Jumby Bay Resort
300 acres

Ashland, Oregon*
Clear Springs Resort
450 acres

Bend, Oregon*
• Broken Top
1,600 acres
• Tumalo Creek Resort
410 acres
• Crosswater
• Pronghorn
640 acres

Carson, Washington*
Carson Hot Springs
150 acres

Clarksville, Georgia*
The Orchards
920 acres

Cle Elum, Washington*
MountainStar
7,000 acres

Grants Pass, Oregon*
300 acres

Klamath Falls, Oregon*
Running "Y" Ranch
3,500 acres

Lincoln City, Oregon*
500 acres

Mt. Hood, Oregon*
Coopers Spur
800 acres

Netarts, Oregon
The Capes
80 acres

Newport, Oregon
• South Shore Resort
80 acres
• Wolf Tree*
700 acres

Redmond, Oregon*
Eagle Ridge
1,000 acres

Sun Valley, Idaho*
524 acres

Sweet Home, Oregon*
Santiam Commons at the
Salmon Run Institute
230 acres

Tillamook, Oregon*
Tillamook Resort
700 acres

Whidbey Island,
Washington*
Holmes Harbor
400 acres

Winthrop, Washington*
Arrowleaf
1,200 acres

Hood River, Oregon
Hood River Hotel

McCall, Idaho
Shorelake Lodge
Membership Club

Newport, Oregon
Waterfront Hotel

N. Bonneville, Washington
Pacific Crest Inn

Sandpoint, Idaho*
Schweitzer Ski Resort

Santa Barbara, California
Miramar Hotel
Condominium Conversion

Nayarit, Mexico*
Los Tres Pueblos
700 acres

Paradise Valley, Arizona
Mountain Shadow Resort
67 acres

* Indicates major mixed use resorts with a variety of resort residential products such as lots, condominiums, hotels, timeshares, fractionals, and a complete amenity package.



WALLACE M. HOBSON

*Founder and President
Hobson Real Estate Advisors*

*Master of Business
Administration
Portland State University*

*Bachelor of Science in
Liberal Arts
University of Oregon*

Wallace Hobson is a real estate advisor with more than 30 years of experience in project management, market research and analysis, real estate development, programming, sales and marketing, financial analysis, strategic planning, and master planning.

He is the founder and president of Hobson Real Estate Advisors, a Pacific Northwest real estate consulting and development advisory firm. His real estate development background includes private and public sector consulting for housing, office, retail, industrial, and recreation/resort development.

For three years, Mr. Hobson was the managing partner for the Pacific Northwest offices of Robert Charles Lesser & Co., a national real estate advisory and consulting firm headquartered in Los Angeles, and managed offices in Portland and Seattle. Mr. Hobson also held positions in marketing, market research, and sales in private industry.

For the last ten years, Mr. Hobson has specialized in the resort industry, domestically and internationally. He is the leading international expert on fractional residence clubs, having worked on more than 80 projects throughout the world.

Project Locations:

- The U.S. Mainland and Hawaii
- Canada
- Europe
- The South Pacific
- The Caribbean
- Mexico
- Latin America
- South America
- New Zealand

Areas of Specialization:

- Resort & Recreation Development
- Strategic Planning
- Market & Financial Feasibility Analysis
- Public Policy Analysis
- Land Sale/Lease Negotiation
- Expert Testimony
- Program Development

Publications:

- “Private Residence Clubs”
Estates West, Fall 2002
- “Private Residence Clubs:
A New Concept for
Second Home Ownership”
Journal of Leisure Property,
May 2002
- “Luxury Fractionals are a
Cutting Edge Opportunity”
ARDA Developments, January
2001
- “Research Report on
Private Residence Clubs”
*International Journal of
Hospitality Management*, July
2002



JENNIFER ILER

*Senior Associate
Hobson Real Estate Advisors*

*Bachelor of Science
University of Georgia*

Jennifer Iler is a Senior Associate with Hobson Real Estate Advisors, specializing in feasibility analyses and developing strategic recommendations for real estate development.

Ms. Iler has a diverse real estate background. Before joining Hobson Real Estate Advisors, Ms. Iler served as Director of Market Research and Analysis at CB Richard Ellis in Southwest Florida. Ms. Iler also held a Florida real estate license. As a commercial broker, Ms. Iler specialized in retail leasing and investment sales.

Ms. Iler is a specialist in the residence club industry with more than three years of experience in research, project management and strategic business planning. Ms. Iler has extensive knowledge of this industry, including development, sales and marketing, operations, and industry trends. Ms. Iler manages the market research, report composition and report production for the firm. Other responsibilities include site evaluation, customer relations and marketing.

Ms. Iler holds a Bachelor's Degree from the University of Georgia. She has also completed numerous courses in Market Research Management and Database Development.

Ms. Iler has completed more than 40 feasibility studies for luxury fractional residence clubs throughout the continental US and abroad, including:

- U.S. Mainland
- Hawaii
- Canada
- The South Pacific
- The Caribbean
- Mexico

Areas of Specialization:

- Resort & Recreation Development
- Strategic Planning
- Market & Financial Feasibility Analysis
- Program Development

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INTRODUCTION

In 2004, the second home industry in North America, Mexico, the Caribbean, and Hawaii achieved record sales volumes. A total of 2.82 million second homes were sold in the U.S., up 16.3% from 2.42 million sales in 2003. This success is attributed to several factors.

- The US economy recovered from a deep recession.
- The threat and fear of terrorism subsided, at least temporarily.
- Cash in money markets languished with the lowest interest rates in decades.
- Confidence in the stock market remained low, and consumers sought alternative investment opportunities.
- Consumers in the US and Canada saw second home real estate as a safe haven for investment appreciation with the opportunity to also enjoy the use of their new asset.
- Second homes also provide investment diversification, which has become a critical concern among consumers since the stock market crash in 2000 and 2001.

Longer term, the aging of the North American baby boom population will create high demand for the next 15 to 20 years, as this segment of the population continues to reach its peak earning years, place a higher importance on leisure time and travel, experience the freedom of being empty nesters, and inherit trillions of dollars.

Baby boomers are the 76 million Americans born in an 18 year time span between 1946 and 1964, who now represent approximately one third of the population of the U.S. The leading edge of the baby boomers have now reached age 59. This generation has dominated consumer demand for all products at every stage of its life cycle, and is now dramatically affecting demand for second home real estate.

In response to growing demand the resort industry has undergone substantial change in the last five years. In order to broaden the market, new products have been invented to better respond to people's needs and pocketbooks.

Annual use of a second home averages only about three to four weeks per year, and even less, in many cases. Thus, second home ownership is impractical for about 80% of the households in the U.S. earning \$150,000 per year or more.

One of the most recent innovations in the second home industry is the introduction and rapidly increasing popularity of luxury fractional real estate, also called shared ownership. Fractionals serve two purposes and are a benefit to both the consumer and the developer. First, they lower the price point so the buyer is purchasing much higher quality than what they could otherwise afford, or they are being more practical and only buying what they have time to use. Second, fractionals broaden and diversify the market for the developer by creating lower price points and usually result in higher profitability when properly conceived and executed.

The purpose of this report is to provide the reader with a clear understanding of the concept, market dynamics and emerging trends of luxury fractional resort products. While there are several types of fractional products that serve different markets and meet different needs. The focus of this report is on the luxury fractional residence club, also called private residence clubs (PRC's). This study is an update of a previous industry overview report completed in March 2002.

In order to better understand the trends and detailed product characteristics of fractional residence clubs, a survey of 23 occupied and operational PRC's and 11 PRC's in presales were completed at the end of the fourth quarter of 2004. There are a total of 1,157 units in these 34 PRC projects.

While the survey may not be a complete sample of the total universe of PRC's, it represents over 90% of what Hobson Real Estate Advisors considers to be a PRC. There are many other projects in the planning stages that will soon begin presales or may have begun presales after December 31, 2004 that are not included in the sample. The results of this survey are included in this report.

The following topics are addressed in this report:

- 1. A discussion of the different types of fractionals.*
- 2. An understanding of the concept of private residence clubs as they are evolving in today's marketplace, including buyer motivation and distinctions from other types of fractional products.*
- 3. A history of the industry and market conditions.*
- 4. Industry trends*
- 5. Reasons for successes and failures.*
- 6. The future of the industry.*

TYPES OF FRACTIONALS

There is industry confusion and semantic problems with the term “fractional” because there are several different types of fractionals that serve different markets. To better understand these differences it is important to note that there are two principal motivations for owning a second home; investment and enjoyment from use of the home.

Fractionals can be categorized into five different types that respond to these two different purchase motivations.

Project Type	Buyer Motivation	Typical Fraction Size	Predominant Product Type
Timeshare	One or Two Week Annual Vacation	One or Two Weeks, or Points	1 and 2-Bedroom Condos
Fractional Condo Hotel	Rental/ Investment	1/4th	1 and 2-Bedroom Suites
Fractional Rental Pool Condos	Rental Income and Second Home	1/4th	Mid-Size 1, 2 and 3-Bedroom Condos
Membership Clubs	Luxury Vacation Time in Multiple Locations	30 to 60 Days per Year	Large, luxurious 3- and 4-Bedroom Condos and Single Family Homes
Fractional Residence Club (PRC)	Second Home	1/7th to 1/12th	Spacious 3 and 4-Bedroom Condos and Single Family Homes

Timeshare

A timeshare provide the owner with an annual vacation in the location of their choice in lieu of renting a hotel room or other type of rental property. Timeshare comes with extensive exchange privileges, usually through RCI or Interval International. Timeshare resales are often heavily discounted, so investment is not a purchase motive.

There are two different timeshare business models. The traditional model is the fixed week interval where a fixed week is purchased for a price that generally ranges from \$10,000 to \$30,000. The buyer receives a right to use the property one week per year.

The second model, which is rapidly gaining in popularity, is a point system where the buyer purchases a designated number of points that are renewed each year. The timeshare company owns and manages an inventory of homes in numerous resort locations and each year the buyer is able to select a week or more, depending on the number of points purchased, at the location of his choice. This system does not include a deed, but rather is a right to use.

Fractional Rentals

The second type of fractional is condominiums, attached townhouses, or a hotel (condo hotel) designed for overnight rentals. These fractionals are usually sold in one fourth shares and each buyer receives one week of use each month, a total of 13 weeks per year. Weeks are assigned through a rotating calendar. The owner either uses or gifts their weeks or they can place it in a managed rental pool and split the rental income with the property manager. Although most condo hotels are sold as whole ownership, the introduction of 1/4th fractional shares is becoming popular in order to reduce the price point and diversify the market.

Statistics show that the market for homes with rental income potential is nearly twice the size of the market for vacation homes that are seldom rented. However, both markets are growing rapidly in double digits. As expected, the typical buyer is at least partially motivated by investment and rental income and may be younger and less affluent than the luxury whole ownership second home buyer.

There are legal complications with this type of product associated with the federal Securities Exchange Commission. Rental income cannot be pooled for distribution back to the owners, the rental pool cannot be mandatory, and the product cannot be sold as an investment without SEC registration which is onerous, expensive, and usually avoided.

There are two types of fractional second home rental products:

1. The first is a true condo hotel with all of the hotel amenities and services, including in some cases, restaurants, retail, spas, and meeting space. A hotel of this type is usually larger with 100 or more rooms. In Las Vegas these hotels are sometimes over 1,000 rooms. The rooms are designed like traditional hotels for short term overnight rentals.

There are various incentive programs for owners to place their time in the rental pool six to twelve months in advance so the hotel management company is able to control the rental inventory. The purchase motivation is mostly annual return and value appreciation.

2. The second type of quarter share rental product is not a hotel, but rather a more typical condominium, or attached townhouse, designed for owner use. The unit sizes are much larger than condo hotels. The most popular size is two bedrooms with a lock off, which then breaks into a one bedroom studio and a one bedroom suite with a living area. This type of product has been offered in numerous resort areas for many years.

In addition to differences in unit design, size, mix, services, common area space, and amenities, an important difference between this product type and a condo hotel is that its owners tend to use their home more and rent less. Annual income from

rentals is important, but is viewed as a way to reduce the cost of second home ownership. Value appreciation is also important to the owner.

While some buyers of this product can also afford whole ownership of a luxury second home, many cannot. Thus, this product satisfies a market niche, at a lower price point, than whole ownership or private residence clubs within the market in which the project is located.

Luxury Membership Clubs

The newest type of fractional is the non-equity membership club typified by *Exclusive Resorts* and *Private Retreats (Abercrombie and Kent)*. This business model has been very successful in the market due to heavy advertising and the appeal of multiple locations. It is similar to a point system timeshare, previously described, but the product and locations are super five-star luxury.

Technically and legally this product is not a fractional, because there is no deeded ownership, but rather a right to use the club's inventory in perpetuity. Thus, members are sharing the second home inventory of the club. The corporation that manages the club owns the inventory. The ratio of members to homes is typically six to one. Thus, from the standpoint of usage it is a 1/6th fraction.

Membership in *Exclusive Resorts*, for example, currently sells for \$375,000 and members are allowed 30 to 60 days of use of homes averaging \$2.5 million in more than 30 locations throughout the world. Annual use varies depending on the membership dues paid which ranges from \$15,000 for 30 days per year to \$25,000 for 60 days a year.

This business model appeals to a different buyer than a site specific PRC where a deeded interest in the real estate is an important buyer motivation.

Private Residence Clubs

A PRC is designed to target and penetrate the same affluent market that would normally purchase, or aspire to purchase, an expensive luxury wholly owned second home. The buyer perceives they are making a real estate purchase and buying a vacation home, not an annual vacation. By sharing the ownership the buyer is purchasing only what he needs and can use, at a fraction of the price of whole ownership.

The typical buyer is 45 to 65, married, often with grown children, incomes of at least \$300,000 per year, and more importantly a net worth typically starting at \$3,000,000.

A residence club should not be confused with fractional condominium hotels, or any other type of resort rental product sold in fractional shares with a managed rental pool where rental income is a strong purchase inducement. PRC's are seldom rented except for unsold developer inventory. Management does not facilitate or encourage rentals. If the owner rents any of his guaranteed weeks, the renter is treated as the owner's unaccompanied guest.

The PRC is designed to sell to an affluent market as an alternative to whole ownership of a second home. It is an emotional purchase and it should fit the image of the buyers “dream home.” When fractionalized the incremental cost of additional space and an extra bedroom is relatively modest compared to whole ownership. The market is price insensitive, and more concerned about how they can use the home.

Although purchase decisions are not driven by investment objectives, the buyer perceives and expects they will receive approximately the same rate of value appreciation as whole ownership in comparable locations. To date this has not been the case with all clubs for various reasons. However, most residence clubs in good locations, in projects fully absorbed are reselling at prices higher than the last developer price.

The fractional residence is usually large and luxurious and appointed with finishes and furnishings comparable to or better than, luxury whole ownership residences that sell for at least \$1,000,000, and sometimes \$5,000,000 or more. PRC's are location sensitive and are most successful in the high end five-star resorts, with strong amenities like a world class resort area.

PRC's typically include a private clubhouse and five-star hotel services that are not available with wholly-owned resort real estate. The coupling of a private club with shared ownership in a vacation home is a trend that adds sophistication and a higher level of exclusivity to the product and a sense of belonging. The club functions like a private equity golf club where the members have the opportunity to interact and form social relationships with other members while in residence.

Property management and hotel services are provided so people can relax while vacationing. The experience is like staying in a five-star hotel, except the member is an owner and pays annual homeowner association dues instead of renting by the night. In addition to the physical product, the developer of a PRC is selling a lifestyle experience.

The residence club is marketed as a real estate investment. The emphasis is on relationship-selling rather than mass-merchandising. It is a soft sell approach. Repeat visits prior to closing are the norm. The target market may have a negative impression of timeshare and will not respond to high-pressure sales tactics or sales gimmicks that are common in the timeshare market.

Fraction sizes generally range from 1/6th to 1/12th and the buyer receives a fee simple deed to a residence in accordance with the fractional size of the PRC. A second form of ownership is a deed to all of the real estate in accordance with the total number of shares (e.g. a 1/160th fee simple interest for 20 units sold in 1/8th shares). Within the fractional industry, PRC's represent the highest end of the market with share prices ranging from approximately \$200,000 up to \$1 million for a 1/8th share equivalent. Common areas are generally owned in condominium by all residence club owners.

Members usually receive 3 to 5 weeks per year of guaranteed time, plus space available time. For example, a 1/8th share usually is sold with four guaranteed weeks which occupies a

home for 32 weeks per year (4 weeks times 8 shares per unit), usually in prime seasons. This leaves an additional 20 weeks per year (52 weeks minus 32 weeks) of space available time when any owner can request additional time on a space available basis at no extra charge.

HISTORY OF PRC's

Fractional residence clubs have evolved from their infancy in the early 1990's to a highly publicized and accepted resort product more than a decade later. The first PRC was the Deer Valley Club in Deer Valley, Utah constructed in 1992. Phase one of the Franz Klammer Lodge in Telluride, Colorado, was the second PRC. Development of the Franz Klammer Lodge began in 1995.

Between approximately 1998 and 2000 development started on five more residence clubs including the Austria Haus in Vail, Colorado, Northstar in Lake Tahoe, California, phase one of the Christie Club in Steamboat Springs, Colorado, the Phillips Club in New York City, and the Roaring Fork Club in Basalt, Colorado near Aspen.

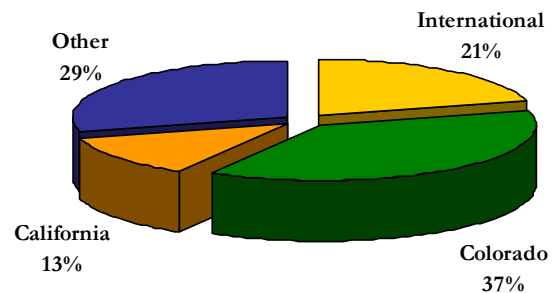
Since 2000 both the supply and demand for PRC's has accelerated and today there are approximately 23 PRC's in operation, four under construction, and approximately eight more projects in the presales stage of development, a total of 34 PRC's. There are probably at least an additional 30 or 40 PRC's in the planning stages.

The majority of occupied PRC's, about 60%, are located in ski resorts where they began. However, the concept is rapidly spreading to warm weather beach and golf resorts throughout the world.

The fractional residence club industry is continuing to change and evolve as the industry matures. However, the industry is still in its infancy, and has not been exposed to the majority of the market. Considering that 80% of the income qualified households in the U.S. do not own a second home, the market is deep. Even 5% market penetration would produce over \$4 billion in sales.

Today, PRC sales agents report that many consumers are aware of the concept and their purchase decision after focuses on where to buy. The time from first contact to an earnest money deposit has shortened considerably. The market is being penetrated at a deeper level, but still remains relatively untapped.

**PRC Distribution by Location
(December 2004)**



MARKET CONDITIONS

Market conditions for PRC's can be divided into three distinct periods.

- 1995 through 2000
- 2001 through 2002
- 2003 to present

In the late 1990's the supply was so limited that there was practically no market and essentially no competition, except from whole ownership. The economic environment boasted the strongest economy in history, the stock market was creating extraordinary wealth, and consumers were buying resort real estate of all types, including PRC's.

During this period the PRC market would have been even stronger if consumers had been more aware of the product. However, because there were so few projects in the market, supply was limited, industry advertising dollars were a small percentage of what is being spent today, and it took more time to educate the consumer about the product and turn a prospect into a buyer.

In the second period, between the end of 2000 and 2003, many more PRC's came on line. However, the stock market weakened beginning in the first quarter of 2000. By 2001, it was clear to everyone that the economy was in trouble and a deep national recession had begun. Many fortunes made in the stock market in the late nineties were just as quickly lost.

By the spring of 2001, real estate sales in many resort areas had slowed dramatically and for the first time in several years, supply exceeded demand. However, the resort and hospitality industry might have recovered much sooner if 9/11 had not occurred.

The effect of 9/11 on vacation travel, particularly air travel, was quick and severe. Overnight real estate sales in many resort areas all but stopped. Low hotel occupancy and slow real estate sales were characteristic of most of 2002.

However, markets have a short memory and by the fourth quarter of 2002, signs of recovery in both the national economy and the resort and hospitality industry were evident.

By the end of the first quarter of 2003, the market had recovered and PRC's were once again flourishing with strong sales, new project introductions, and a renewed excitement by practitioners in the industry. This trend continued to accelerate through 2004 and is even more pronounced in 2005. The PRC today has never been healthier or stronger.

Today, industry absorption is well above pre 2000 levels, due to both greater supply and demand. The industry is showing signs of pent up demand in many locations as consumer awareness increases. Sellouts prior to the completion of construction are occurring with well located and designed PRC'S.

INDUSTRY TRENDS

There are a number of important trends that will continue to shape the PRC industry in the future.

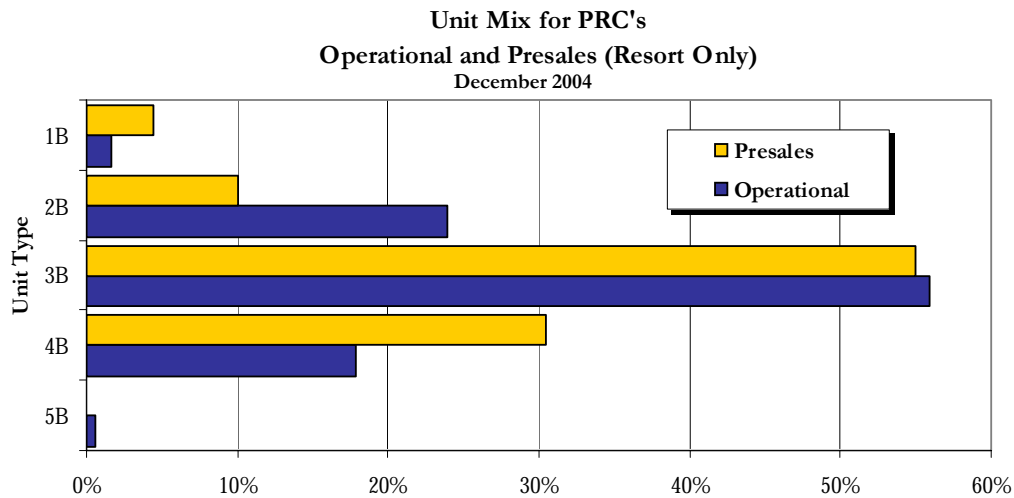
Product

The PRC product consists of the location, the physical design, and the usage plan and reservation policies and procedures that overlay the usage plan. The importance of the location cannot be over emphasized and is discussed in more detail in a subsequent subsection of the report.

With respect to the physical product there is a wide variation in building types that includes

- Low density detached single family homes.
- Low to medium density attached townhouses on separate townhouse lots.
- Medium density stacked condominiums in mid-rise buildings.
- Urban high rise mixed use buildings (high density).

The type of construction in medium density projects includes both wood frame and concrete and steel, depending on the height of the building. Density is driven mostly by land price, but should be consistent with the degree of the rural or urban character of the surrounding environment. In large mixed use destination resorts, with a wide range of densities, the PRC can be either low or medium density.



Irrespective of the density, there is a pronounced trend towards larger homes with higher quality finishes and higher price points. Unit size and mix is trending towards three and four bedroom homes and away from two bedrooms, except in urban areas. Among projects in

the planning stage, a three bedroom home typically ranges from approximately 2,400 to 3,000 square feet. A four bedroom home is often over 3,000 square feet, but seldom less than 2,700 square feet.

Unit designs include two relatively equal twin master bedrooms with somewhat smaller third and fourth bedrooms. However, each bedroom has its own private bath. A half bath is usually located somewhere off the living area. Great rooms are common and create a feeling of luxury and openness.

Each home should have a small study or den with a desk for a home office. This room can also function as an overflow sleeping area with a hide-a-bed. Large outdoor living spaces connecting to the living area and the twin master bedrooms is also critical, particularly in warm climates where outdoor living is an important part of the lifestyle.

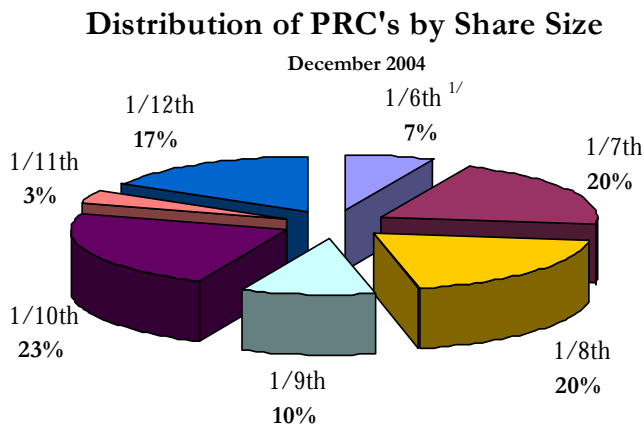
Naturally, the land plan should orient as many units as possible towards the view amenity. Units should be designed with large floor to ceiling windows to provide unobstructed views.

The amenity package should include a private members lounge with a check in area, management office space, a small outdoor swimming pool, and a small fitness room. Storage space is also needed with a storage locker for each member.

There is a trend to enhance the amenity offering with private golf club memberships, while in residence, private yachts, fractional jet service, beach clubs, and other similar types of offerings. These types of lifestyle additions further enhance the marketability and perceived value of the PRC

Usage Plan

The structure of the usage plan is unique to fractionals and in order to design a suitable plan one must first identify and thoroughly understand the needs of the market being targeted. Usage plans for drive in markets with shorter more frequent stays must be distinguished from fly-in markets.



One of the mistakes made in the industry is attempting to sell on the basis of price alone. Generally, the price of a PRC is relatively inelastic and consumers are much more concerned with use and annual homeowner association fees. Fraction sizes, in some cases, have been too small and the market perceives the project is more aligned with timeshare.

One of the most important fundamentals of a PRC is that the prime season or seasons are not oversold. For example, most Rocky Mountain ski seasons are approximately 14 to 16 weeks. Although the mountain may be open longer, most visitors want to take two weeks of winter vacation sometime between the last two weeks of December through March. Thus, a fraction size of 1/7th or 1/8th allows two weeks of prime time use in the winter and two weeks in the summer.

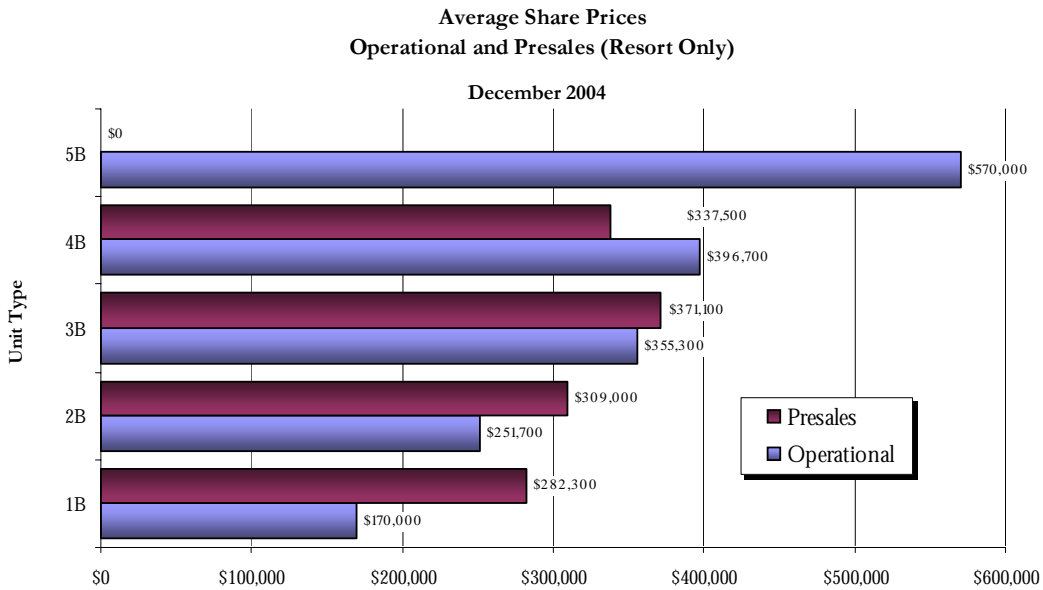
The industry trend is towards larger fractions of at least 1/8th to provide more time. A 1/8th share provides four guaranteed weeks of time per year, leaving 16 weeks of open access time when any member can use the club at no additional charge for up to seven days. There has been a proliferation of usage plans with a wide variety of fraction sizes and guaranteed weeks. However, this range is usually within 1/6th to 1/12th fractions. Smaller fractions than 1/12th begin to cross the line into timeshare, particularly when fixed weeks are sold and priced differently based on the season.

Occupancy in private residence clubs in ski areas averages over 80% in the winter, with full occupancy during prime weeks like Christmas, President's Week and spring vacation. Occupancy averages about 60% to 70% in the summer, and 30% or less during the shoulder seasons.

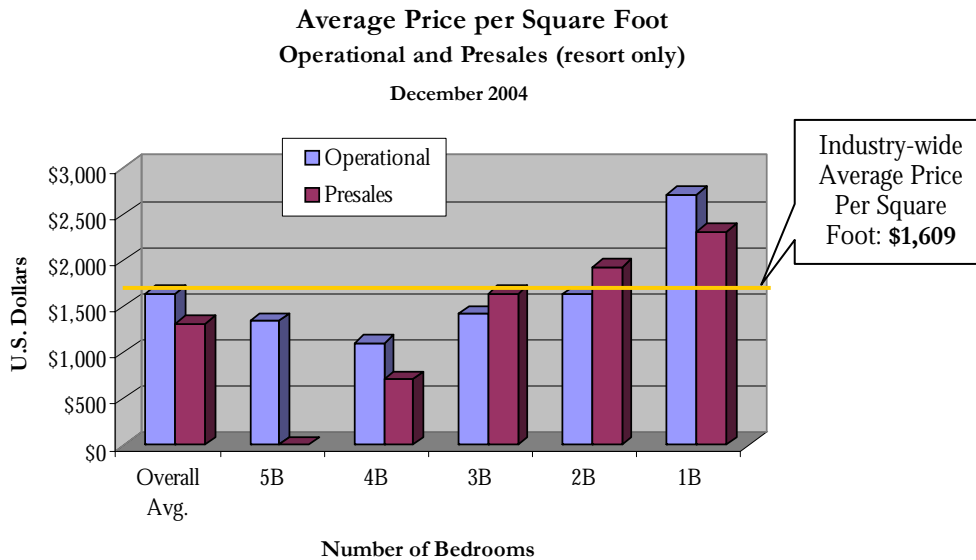
Warm weather climates with long seasons usually experience higher average annual occupancy than ski areas. In spite of relatively high occupancy patterns, most owners are able to use their residence club, even in the prime season, as much as their vacation schedule allows using a combination of guaranteed time, open access time and space available from cancellations.

Pricing

Share prices are trending much higher together with larger sizes and more exclusive locations. In the 1990's share prices were seldom over \$300,000 and often began well under \$200,000. Today, average prices for new PRC's are in the mid \$300,000's and range up to \$1,000,000. It is not unusual to find three and four bedroom residence clubs priced at over \$500,000 per fractional share.



Prices per square foot are also increasing and there are many projects selling for well over \$1,000 per square foot in exclusive five-star national and international resort destinations. The highest price in the market is \$3,600 per square foot. A select number of projects in the planning stages will sell for over \$2,000 per square foot. The industry average is approximately \$1,600 per square foot.



Pricing a fractional residence club has traditionally been based on determining the whole ownership value of the product, applying a multiplier varying between approximately 1.6 and 2.0, and dividing by the total number of fractional shares for each unit type.

This pricing strategy is utilized due to the immaturity of the industry and the absence of other fractional comparables in the locations where they have been built. Thus, the market is

inefficient and since the principal competition is whole ownership, the relationship between the two should not be too far out of balance on the basis of price per square foot.

Generally, the opening multiplier is relatively low to allow for price appreciation. On the average, most PRC's will experience at least a 30% price increase between opening and the last developer price. It is a better strategy to begin with a lower price to help establish momentum and send a positive message to the market. Rapid absorption initially also creates more urgency to buy through excitement over the initial success of the offering.

The number of units built should be structured around a realistic absorption target that will result in a sell out of no more than three years after completion, with two years being optimal.

After two to three years members begin to resell their memberships and the developer must compete with these resales if the project has not been fully absorbed into the market. This condition can substantially slow new developer sales.

Mixed Use Resorts

The concept of complete mixed use master planned communities has taken over the resort industry. While these destination resorts used to be hotel driven, they are now real estate driven. Hotels and golf courses are built to create a destination for the purpose of selling real estate.

PRC's are becoming an accepted component of the real estate product mix for destination resorts. Thus, fractional residence clubs are being sold side-by-side with whole ownership vacation homes and condominium hotel rooms. This relationship is symbiotic rather than competitive. Cross marketing can occur and buyers who resist whole ownership because of price can be directed to fractionals, and vice versa. It is not uncommon to mix PRC's and whole ownership and/or hotel rooms in the same structure.

Hotels and PRC's

One of the most evident trends in the PRC market today is the increasing involvement of five-star hospitality companies. The PRC is often coupled with a hotel because there is a synergistic relationship between a PRC and a five-star hotel.

Management and the quality of service are extremely important to the PRC owner. The experience of using the home can be enhanced by a five-star hotel operator.

The residence club can be within the same building or a location near or adjacent to the hotel. The hotel company brands and operates the residence club. The residence club provides the hotel with additional operating revenue and greater efficiency. The residence club members, on the other hand, receive the benefit of the hotel amenities and services. Currently there are at least eight residence clubs combined with hotels with many more in the planning stages.

The hotel can also play a critical role in the sales and marketing of the PRC through traffic generation. Often the hotel guest list is used for direct mailing to prospective buyers. This is a valuable resource and the best direct mail list that can be obtained. Joint advertising and promotion is often utilized with the hotel inserting a flyer describing and promoting the PRC in the literature and promotional offers they send to previous guests.

The hotel also generates traffic and can refer hotel guests to the sales office of the residence club. Sometimes a kiosk or sales office for the PRC is set up inside the lobby of the hotel and brochure materials are placed in the rooms. A referral from a hotel establishes credibility for the PRC in the mind of the buyers.

There are new projects in the planning stages in urban markets where a hotel or condominium hotel, a PRC, and whole ownership condos are all combined together into a single high rise tower. There are at least two mixed use high rise developments planned in Las Vegas with over 1,000 units each, which will combine a condo hotel and whole ownership condominiums with a PRC.

Hospitality Branding

Perhaps the most important trend in the PRC industry is branding by five-star hospitality companies. It is possible that branded PRC's may dominate the industry. *Ritz-Carlton* is the leader and was the first hospitality company to brand a PRC. *Ritz-Carlton* has branded and is operating four residence clubs; two in Colorado, one in Florida, and one in St. Thomas in the Caribbean. Ritz is in the planning stages with several more clubs in Mexico, Hawaii, Southern California, San Francisco, and other locations.

	Branded	Unbranded
Residence Clubs	12	22
Number of Units	561	593
Number of Shares	5,924	5,009
Avg. Monthly Absorption	10.3	6.5
Avg. Price Per Share	\$309,000	\$308,000
Avg. Price Per Sq. Ft.	\$1,897	\$1,388
Avg. Annual HOA Dues	\$9,871	\$8,316

A brand generally provides a price premium in the market of approximately 20% to 30%, sometimes higher. The buyer has comfort in the brand and feels he is getting more for his money, even though a brand adds to the cost of the fraction. The market feels more secure in their investment and the pace of sales is usually accelerated.

The five-star hospitality companies that are in the market or under development are shown in the table below. All of these brands are in the planning stages with additional projects.

**Branded PRC's
Occupied and Under Construction**

Brand	Number of Projects	Locations
Ritz-Carlton	4	Aspen & Vail, CO, Jupiter, FL, & St. Thomas, USVI
Auberge	2	Los Cabos, MX & Napa Valley, CA
St. Regis	1	Aspen, CO
Four Seasons	2	Jackson Hole, WY & Papagayo, Costa Rica
Fairmont Resorts	2	Acapulco, MX & Telluride, CO
Marriott	1	London, England
Total	12	

There are several five-star hospitality brands planning to enter the PRC market including *Regent*, *Mandarin*, *Rosewood* and *Raffles*.

In addition to the national brands shown above, there are two local five-star brands that are operating or will operate fractional residence clubs in Vail, Colorado (Austria Haus and One Willow Bridge Road, operated and branded by the Sonnenalp Hotel) and Aspen, Colorado (The Little Nell Hotel).

Other brands are also emerging. *Storied Places*, a division of *Intrawest*, was formed to develop and brand PRC's and has completed two projects and has four or five more projects in the planning stages. *Ferrangamo* is branding a PRC in Tuscany, Italy and may brand other hotels and PRC's. *The Timbers Company*, whose first project was in Snowmass, CO, is establishing its own brand with multiple locations and a loyal following.

The strong interest in PRC's by the five-star hospitality industry is further evidence of the increasing importance and viability of the PRC product.

Exchanges

Exchange opportunities in the PRC industry are relatively undeveloped. There is only one company, *World's Finest Resorts*, which offers an exchange program for PRC developers. The developer pays an up front fee to join the PRC exchange. Individual owners then pay an annual fee to remain in the exchange program and an additional fee is charged each time an exchange is facilitated by the exchange company.

A second type of exchange is evolving through developers who are building multiple PRC projects. This is an internal exchange among an inventory managed by a PRC development company. The best example is the *Ritz-Carlton Club* with four existing projects and others in the planning stages. *The Timbers Company* also has an internal exchange among the three

projects they operate. *The Timbers Company* will be adding to this exchange with the development of several more projects, also in the planning stages.

Financing

While consumer financing through a mortgage on deeded interest in a PRC unit is readily available to qualified buyers, development financing for marketing and building a PRC is much more difficult to obtain. The historical absence of real estate or timeshare finance companies who are interested in providing development loans to PRC developers has been generally limited to two (*Textron* and *Capital Source*). This absence of financing sources has been a major deterrent to the entry of new PRC's into the market.

However, as the PRC industry continues to gain momentum, new financing sources are emerging and the product is beginning to get the attention of Wall Street. A major Wall Street investment banking company is financing a PRC project in Aspen.

Furthermore, as more large real estate developers become interested in fractionals they bring their own lines of credit and financing sources for the development of PRC's. Thus the financial markets for PRC development loans are evolving rapidly.

Equity in PRC's has historically been raised mostly through private investors. However, new institutional equity sources are also beginning to emerge. The opportunity for unusually high returns is a major attraction to Wall Street.

Urban Fractionals

Currently there are only two urban fractionals in the world, the Phillips Club at Lincoln Center in New York City and the Marriott Grand Residence Club in the Mayfair District of London, England. However, as previously mentioned there are a number of PRC's in the planning stages in high rise buildings in urban areas. The PRC, in these cases, functions as a compliment to a condo hotel, whole ownership condos, or both.

The potential for urban fractionals is excellent in the right locations. The best urban regions are cities with established international business centers and a strong tourism base. In the U.S. the best locations include New York, San Francisco, Miami, Chicago, Las Vegas, Washington D.C., and Boston. Most cities, however, do not qualify. In Europe and Asia prime locations include London, Paris, Hong Kong, and Shanghai.

Urban fractionals have several markets including:

- Repeat urban tourists.
- Households living in surrounding areas who come to the downtown to enjoy cultural events, shopping, and other activities. These households also will use a residence club for lodging family members and friends.
- Repeat business travelers.

- Private corporations or partnerships with multiple regional offices.

Because of the multiple sources of market support and the number of annual visitor's urban markets tend to be deeper than most resort markets. The deepest of all markets is Las Vegas which is the world's largest urban resort.

Urban fractionals can take many forms both large and small, but are usually high density. The Marriott Grand Residence Club in London is a medium density development of 49 units in an eight story building in an affluent historic residential neighborhood. However, the predominant form in the future will be high rise buildings with a mix of whole ownership and/or hotel rooms.

Members use urban PRC's in different ways. For example:

- The club can be a launching place and home base for members on holiday. They arrive in the City and stay several days to rest and recover from jet lag while enjoying the many amenities of the city.
- International businessmen can also use the PRC as a home base for travel to other cities. Businessmen typically use the PRC several times per year and stay three or four days per visit.
- Owners will also use an urban fractional for up to three weeks at a time. Thus, there are requirements for both short and long term stays.

Other Trends

Other market trends include:

- A transition from individual entrepreneurs to major real estate development companies who may dominate the industry in the future;
- Residence clubs will spread overseas to Europe, Asia, and other countries; and
- Residence clubs will gain market share against whole ownership.

SUCCESSSES AND FAILURES

While luxury PRC's have become an accepted product in the market place, financial results have been mixed. Aside from the external effect of the economy, there are numerous reasons why some private residence clubs have been successful while others have struggled or failed. The factors that have contributed or detracted from success are summarized as follows:

- Location.
- Product design.
- Use structure.
- Marketing plan and execution.
- Pricing and HOA fees.
- Competition from resales.

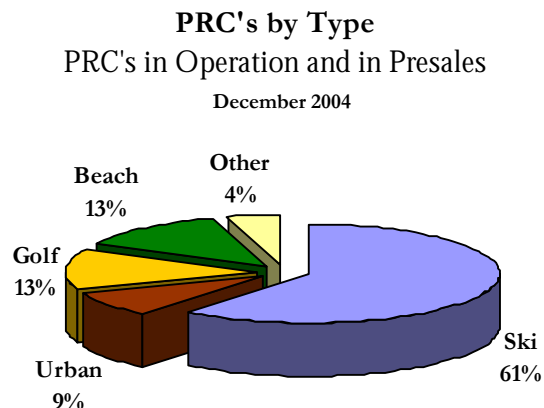
Location

Regardless of the product, the success or failure of resort real estate is dependent upon the quality of the location. Luxury residence clubs work best in locations where vacation homes are expensive and out of reach to all but the most affluent households in America. A fractional offers an opportunity for someone with less income and net worth to buy a luxury home in an area where they would otherwise be excluded.

Location requirements include an established national or international resort or urban area, a significant volume of tourist traffic and affluent repeat visitors seeking a second home, and a location with natural amenities and high priced resort real estate.

Major amenities such as a ski-in/ski-out site, frontage on an ocean or other large body of water, a high end exclusive golf course in an established destination golf resort, or a highly desirable urban location is critical. These types of amenities are needed to create the type of view orientation the affluent market is seeking. Five-star locations are usually characterized by land scarcity and high land prices, coupled with a difficult and lengthy entitlement process that limits competition.

Access is another important factor contributing to or detracting from the success of a PRC. Projects accessible to large markets by both air and automobile have a significant



competitive advantage. Consumers typically will tolerate three to four hours of travel time to reach a favorite destination by automobile, perhaps more by air. A unique location can sometimes attract a market in spite of poor access.

Product Design

Mistakes in product design include the wrong unit mix and sizes, poor floor plans, inadequate back room and storage space, and many other flaws, some apparent and others more subtle. The inclusion of too many two bedroom units, or units that are too small, has been a repetitive problem. Affluent second home buyers often travel with friends and family and want more space. Three and four bedroom second homes are the norm. Two bedrooms are in far less demand, except in urban areas or where the property is being positioned in the market for overnight rentals.

There is no “cookie-cutter” approach to fractional residence club development. Each location is unique and the product should be designed specifically to penetrate the target markets that the location attracts. Competitive positioning and market differentiation are critical components of the development program.

Other mistakes revolve around the usage plan and fraction size. In some cases developers have reduced the fraction to lower the price point in order to increase absorption. For example, a developer selling 1/8th shares adds a 1/16th share to the program to reduce the price.

Reducing the fraction size in this manner to lower the price point is often a case of trying to solve the wrong problem and cheapens the offering in the eyes of the buyer. However, the industry is changing rapidly and it is likely that smaller fractions, in locations where the market is less affluent and more price sensitive, will be successful. At some point the distinction between a luxurious timeshare and a more modest PRC becomes gray and perhaps irrelevant, except in location characterized by high prices, exclusivity and dominated by affluent households.

Marketing and Sales Plan

The market plan and its execution are also critical and difficult to overcome when mistakes are made. Both the quality of the plan and the execution of the plan will have an effect on absorption.

The market plan includes, but is not limited to the following:

- A presales program that mitigates risk and meets development loan requirements associated with PRC's.
- Setting up an attractive sales office.
- Design and production of high quality marketing collateral materials;

- Implementation of direct mail and intercept marketing programs and other methods for reaching the target market.
- An outside sales broker program.
- An owners' referral program.
- Hiring, training, and managing a professional sales staff; and
- An adequate marketing budget usually equal to 15% to 20% of revenue, which fluctuates by project depending on total revenue and the method selected for reaching the market.

The presales program ideally begins three to six months before ground breaking and continues through the construction period. Initially, reservations with fully refundable deposits are taken and then converted into non-refundable earnest monies and placed in an escrow account when the proper legal documents are in place.

When the period from reservations to non-refundable earnest money deposits is greatly extended, due to construction delays or beginning presales too soon, many reservations disappear and the conversion rate of reservations to non-refundable deposits is low. Sales and marketing costs increase significantly. A conversion rate of 70% or more is excellent, while 50% or lower is disappointing.

The developer is sometimes in a quandary because reservations are usually required before a development loan is funded. However, the due diligence process for obtaining a development loan can be lengthy and significantly delay construction, thus extending the presales period.

This conversion rate is also greatly affected by the buyer relationships formed during the presales and construction. Continuous communication with reservation holders through email, group meetings, direct mail, and a web site is essential.

Pricing and HOA Fees

Pricing and homeowner association fees are a critical component to any real estate project. Consumers are sophisticated and perceptive with respect to recognizing value.

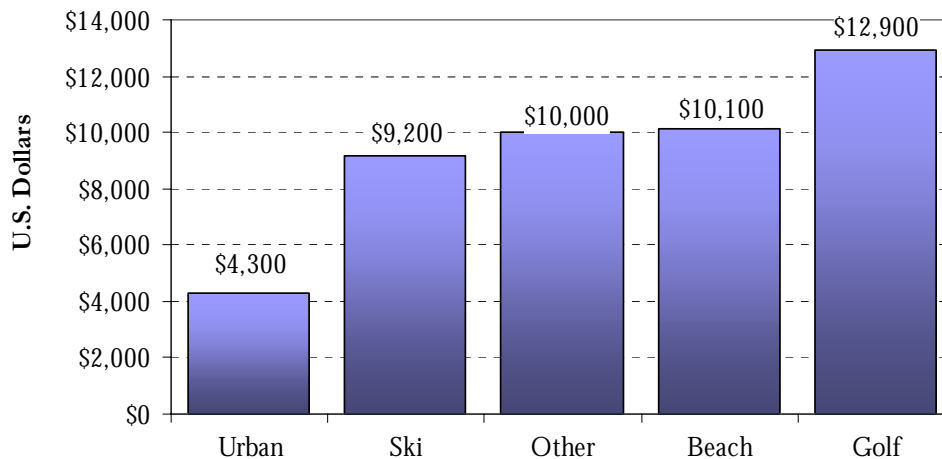
Some developers have created a price umbrella by setting prices to achieve unrealistic margins, sometimes as high as 40% to 45% of gross revenue. With this pricing strategy, competitors can easily enter the market and create a better product at a lower price and still achieve a satisfactory return. It is important that a consumer views their purchase as an excellent value.

The pricing relationship between comparable wholly owned real estate in the market area and fractional PRC shares must be carefully evaluated since whole ownership is the competition in markets where other PRC's are not present.

A prudent pricing strategy is using a conservative opening price multiplier of 1.6 for unbranded clubs to create sales momentum. Price increases of 5% to 10% can be implemented approximately every six months if sales targets are met. With this approach, it is possible to average a 1.7 to 1.8 multiplier over the life of the project. Projects with five-star brands can charge more and use higher multipliers than unbranded clubs.

In most cases, buyers are more resistant to annual homeowner association fees than the purchase price. HOA fees must be competitive with other PRC's and budgets should be structured so the basics are covered and user fees are charged for additional services.

**Average Annual Homeowners Association Dues
by Location Type
(Operational Clubs Only)**



Competition from Resales

Because the PRC industry is new, there is only a limited amount of information on resales. Thus, for most residence clubs, competition from resales has not emerged as a strong obstacle to new developer sales, except in a limited number of cases.

Resales usually begin two to three years after opening when consumers, for various reasons, decide to sell. In some cases buyers are speculators who purchase during an introductory offering at a discounted price with the idea of selling later at a profit once prices increases.

Resales are a greater concern for PRC's than whole ownership when the fractional share is listed with an outside broker who has no experience selling fractionals. In this case the sale is often made by discounting the price below the developer sales price. This problem is also exacerbated with fractionals because the use usually rotates among similar types of units. Thus, the product is homogenous and can become a commodity in the resale market.

For all of these reasons it is important that the developer provide a resale program to the club owners that will induce them to retain the developer as the resale agent instead of going to an outside broker. A developer resale program begins with maintaining a relationship with the owners that fosters loyalty.

Generally, the buyer must be guaranteed that the resale will receive exposure to prospective buyers. A strategy that has been employed in the industry is to market a resale for every four or five new sales. The owner then has an expectation that the resale will occur in a reasonable amount of time for the same price as new developer sales.

Controlling resales is a critical factor in the PRC business. Because of the number of sales that have to be made, if the developer still has inventory when resales begin it is more difficult to make new developer sales and absorption can slow. The PRC should be sized based on absorption expectations so the project is fully absorbed within two to three years after occupancy.

FUTURE OF THE INDUSTRY

The resort industry is entering a period of explosive growth. While sales will ebb and flow as economic cycles come and go, the long term trend will produce dramatic growth in the second home real estate industry. PRC real estate is a niche product within this industry that serves the needs of two markets.

1. There is an affluent market that can afford a whole ownership second home perhaps in the multi million dollar range. However, time constraints make second home ownership impractical. Many of these households have been sitting on the side lines, wanting the use of a second home for a few weeks per year, but not the responsibility and the corresponding investment in an underutilized asset. A variation of this market is the household that already owns a second home but feels guilty, due to infrequent use, and are tired of the responsibility.
2. Another market is the less affluent market that aspires to the status and luxury of a high priced second home, but cannot afford five-star quality.

Thus, as the second home market grows, the PRC market will grow at least proportionately. An argument can also be made that the PRC market will grow much faster than whole ownership.

First, the base is significantly smaller so the percentage of increase will be greater. More importantly, there are many more households that fall into the category of the two markets described above, than households who will only consider whole ownership.

However, PRC's will compete not only against whole ownership, but also against the other types of fractionals described in the first section of this report, with the exception of timeshare. The price point of timeshare is so far below other types of fractional real estate that the market is completely differentiated and noncompetitive.

The future market share of PRC's, in relation to whole ownership and other types of fractional real estate, will be governed by several factors:

- Price appreciation in the resale market.
- The degree to which development financing is available in the future, which has been a major constraint to the growth of the supply in the past.
- The rate at which consumer awareness of the product increases in the future.
- The financial success of future projects now in presales and the planning stages of development.

Due to the relative immaturity and lack of experience in the industry it is difficult to forecast the degree to which the above factors will influence growth positively or negatively.

However, the prospects of much higher returns will certainly drive developers to continue to test and penetrate the market.

As developers gain experience they will innovate and find solutions for overcoming buyer objections and better meeting consumer needs through product design, pricing, usage plans, and the application of effective sales and marketing strategies. Real estate developers are quick to learn from their mistakes, and the mistakes of others in the industry.

The market entry and rapid growth in participation of major five-star hospitality companies is certainly a testament to the viability and importance of the product. This branding also provides consumer confidence that the product is viable and here to stay.

The future and growing importance of PRC's as part of the resort product mix is assured. The concept appeals to the logic of the majority of working households for whom whole ownership of a second home is impractical. PRC's provide a type of ownership that is not only affordable, but fulfills a dream.