PROSKAUER ROSE LLP

Branded Real Estate

Introduction

The past twenty years have seen a substantial increase in the variety of real estate products associated with branded hotel operating companies. In addition to traditional hotel rooms, many branded hotel operators have permitted their carefully cultivated brand identities to be associated with, and a large percentage of their revenues to be driven by, products not previously known to the marketplace. These include various "for sale" real estate products such as branded residences, whole ownership rental products, shared ownership products (timeshare, fractional and private residence clubs) and club or membership products (commonly referred to as destination clubs), as well as serviced apartments, a rental product geared to longer-term occupancy with varying degrees of amenities

This article describes the characteristics of these products, some of the considerations that can impact the success of one product relative to the others, and some of the broader issues affecting brands and developers in connection with the different products. Keep in mind that much of the terminology used in conjunction with the products discussed is relatively new and may be used by different people to refer to subtly different products. We attempt to define terms in accordance with the meaning most commonly attributed by market participants.

The concept of branding entails certain characteristics that are common to all product types discussed. In each instance, a company recognized in the market for the delivery of certain services in accordance with established standards, permits its brand identity to be associated with a particular product. In the hospitality sector, this “branding” has been most prevalent in the context of traditional hotel rooms, frequently built and owned by a third party although sometimes owned by the brand itself. The brand identity, consisting of design and operating standards, as well as names, phrases and business systems, is associated with the hotel from the pre-opening phase of development through the end of the contractual period specified in the hotel management or license/franchise agreement. In return for the brand association, a hotel pays a percentage of its revenues, typically its room revenues, to the brand as a license fee. Where the brand also manages the hotel, this fee is frequently subsumed in the management fee. Upon the expiration or other termination of the hotel management or license/franchise[1] agreement, all use of the marks ceases and any physical manifestations of the marks are removed, and the hotel is disassociated from all centralized services of the brand, including, most importantly, the reservation system.

Associating a brand with a for sale product creates some issues that are different than those faced by the traditional hotel model. When a brand is associated with a for sale lodging product, the owner of the brand typically charges a fee for the use of its marks in connection with the sale of the product. This scenario differs from the typical hotel transaction in that the royalties on sale represent an additional source of revenue, and one that is realized before operations even begin. Further, the activities required when sales have been completed and the product is operational are sometimes quite different from those of a traditional hotel and therefore entail different fee structures. Moreover, the branded for sale lodging product may not be managed by the brand at all and may be less susceptible to clear brand operating standards than is the case with a traditional hotel product.

One of the most difficult questions raised by these new areas of branding is the impact of a termination of the branding of the hotel component on the branded for sale lodging product within the project. While the brand will expect to terminate its license for all project components at that time, the purchaser, having paid a substantial premium for the branded for sale lodging product, can be expected to react quite strongly to the loss of the brand identity. Does this result in a lawsuit against the developer as well as the brand? What is the impact on the ability to attract another suitable brand for the hotel or for the for sale lodging products? What of the specialized services performed in a branded for sale lodging product (such as a whole ownership rental project or shared ownership project) that are quite different from those routinely performed by a traditional hotel operator? Although an exhaustive treatment of these issues is beyond the scope of this article, we do address them in a limited manner in the context of the various products, industry norms and trends.

Branded Lodging Products – Defined and Differentiated

The following is a description of the primary types of branded real estate products.

- **Branded Residences**. Branded residences should be thought of as a true residential real estate project. For example, a stand-alone condominium, a villa or townhome, or even a free standing single-family residence. A branded residence is typically developed in conjunction with a traditional hotel (offering transient occupancy hotel rooms), although this is not always the case. For example, Ritz-Carlton offers "The

[1] The right to use the brand systems and the obligations associated with it are sometimes the subject of a "franchise agreement" and other times merely a license agreement. The distinctions are outside the scope of this article.

Residences at the Ritz-Carlton", a product typically associated with a traditional hotel, and "The Ritz-Carlton Residences", a residential product not typically associated with a hotel. The latter includes projects such as The Ritz-Carlton Residences, South Beach (Miami) and the Ritz-Carlton Residences, Singapore (currently in sales and under construction). Nevertheless, the association of a branded residence with a traditional hotel is the predominant model, and for good reasons. The economic synergy of hotel guests and residents sharing certain services and facilities, even if some are accessible only by residents, has a powerful impact on charges to be paid by owners of branded residences. As experience with branded residences remains somewhat limited, there is still uncertainty as to whether the buyers of these residences will be satisfied with the value equation for this amenitized (i.e., pampered) lifestyle, which can vary across the different segments of the chain scale. However, from an operator's and owner's point of view, the ability to leverage the existing services and facilities to both classes of "guests" (transient and permanent) is very attractive. There are numerous branded residential projects in Asia in different stages of planning or development with a broad variety of brands such as St. Regis, Ritz-Carlton, Mandarin Oriental, Raffles, Banyan Tree, Kempinski, Six Senses and Conrad, in locations including Bangkok, Phuket, Koh Samui, Singapore, Jakarta, Bintan, Kuala Lumpur, Manila, Taipei, Danang and others.

Use and Occupancy

As previously stated, residences are designed for longer periods of occupancy. The governing documents (covenants and restrictions) for a branded residential project will typically prohibit short-term rentals. Longer-term rentals (typically leases of six months or more) are often permitted, although they may be limited to one time per year. Owner occupancy and occupancy by friends and family of the owner will be unlimited. A branded residence can be expected to include a full kitchen, extensive closet space and other features typical of a traditional residence. While furnishing packages are sometimes made available there are typically no restrictions on interior décor as the units are usually not eligible to be placed into a branded transient occupancy rental program.

Services

A branded residence can be expected to have access to a rich menu of amenities and services commensurate with the lifestyle associated with the particular brand. Some of these amenities and services are available to all residents based on a shared assessment, computed without regard to usage. These are sometimes referred to as "mandatory services"[2]. Other amenities and services, commonly referred to as "à la carte services", are available to all residents but a charge is imposed on a per use basis. An example of a mandatory service is the use of the concierge or a library,

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[2] Assessments for mandatory services are most commonly allocated either (a) evenly to each unit irrespective of its size or value, or (b) based on the amount of physical space within the residence.

lounge or card room. Examples of à la carte services would include spa services and housekeeping. The nature and extent of services vary with the brand and are based on the scope and nature of the project of which the branded residences are a part.

Nature and Extent of Branding

The elements of the relationship between a branded operator and the owner of a branded residence include the following:

- The first indication of the brand involvement is the use of brand marks in connection with the offering and sale of the residences. Use of the brand's marks can be expected to take place pursuant to a license granted by the brand to the developer of the project, for the purpose of selling residences as "XYZ branded residences". In return for allowing the brand's marks to be used, the branded operator typically receives a royalty that can be expected to be within a range of 2% to 6% of the sales price of the residence. This royalty is typically paid by the developer at the time of transfer of title to the residence. In many instances, the brand requires a payment of a non-refundable fee at the initiation of the sales and marketing process and provides a credit against next due royalties to the extent of the prior payment. In some instances the royalty is negotiated such that a larger percentage is paid, but only against the portion of the purchase price in excess of a pre-determined threshold. The threshold is typically an estimate of the price at which the residences would be expected to sell without the brand association.
- Given the association of the brand with the offering and sale process and the residential product itself, both are the subject of regulation by the brand and the imposition of brand standards[3]. The brand typically enters into a technical services agreement with the developer, similar to that used in connection with the development of a traditional hotel. Under that agreement, the brand establishes a procedure for the review and approval of plans and specifications for the residences. The brand also requires an agreement governing the sales and marketing process for the residences, which is usually referred to as a sales and marketing license agreement, although the name of this type of agreement varies from company to company. The sales and marketing license agreement is an important document that addresses the prerequisites to use of the brand in the sales and marketing efforts, the conduct of sales and marketing efforts, reporting obligations with respect to sales and marketing, a mechanism for secret shoppers to assure developer compliance with the brand requirements and, of course, the details of the required royalties payable to the

[3] The enforcement of brand standards is discussed briefly under "Typical Issues and Overriding Considerations," below.

brand. Brands do not typically staff or manage the sales and marketing process at a particular project, although they usually approve the sales and marketing team, sales center, marketing materials, and use of marks. One of the difficult issues that brands and developers face is the timing of the use of brand marks in connection with sales and marketing activities. On the one hand, the brand does not want its marks to be exposed to the public in connection with a project that may not actually be developed and opened. On the other hand, lenders frequently require presales of for sale lodging product as a precondition to funding construction and development loans, necessitating the branded sales and marketing activity prior to even an assurance of market acceptance for the project and financing. This tug of war is simply one of the many issues to be negotiated in the context of this type of transaction.

Sales and marketing license agreements typically address both the ability of the brand to associate with other similar projects within a region, and the developer's right to permit competitive products associated with other brands, or perhaps even competitive unbranded products, within the complex or resort. Given the existence of international sales centers and web-based marketing, these issues can be somewhat complex to resolve to the satisfaction of both parties.

- Another aspect of branding pertains to use of the marks in the operation of the day-to-day management of the residential portion of the project following the transfer of title to residences by the developer to the initial purchasers. The functions entailed can be placed into three categories: (a) the provision of services and management of amenities (such as housekeeping, food and beverage, beach clubs, golf, marinas and clubhouses), (b) the provision of residential community property management services (such as landscaping within the residential component of the project, common elements limited to the residential portion of the project, the exterior of the residences themselves, as well as some landscaping surrounding the individual residences themselves), and (c) administering the business affairs of the residential component of the project (such as budgeting for the residential component assessments, levying and collecting assessments, and enforcement of maintenance standards). In these areas there are differing views by the brands themselves. Some brands prefer to manage the three areas described, while others prefer more of a narrow license arrangement even within projects in which the brand operates the hotel and certain other portions of the resort. There are advantages and disadvantages to each position, and the availability of other qualified companies to perform these services and maintain brand standards is an important element of the analysis. There is a difference of opinion on this subject among developers as well, and the brand's position on these issues may be an important factor in brand selection.

Fees for ongoing management services vary with the scope of services, but tend to be structured as a cost reimbursement, plus either a percentage of the assessments or a fixed sum (subject to escalation based on an index). Typically, there is some focus on the fees of unbranded residential property management firms for these services. In the U.S., it has become somewhat common to see a fee of 10% of assessments. However, some larger brands have come to see this management function as being quite time-intensive and requiring a greater level of personal involvement with residents than is found in unbranded property management situations, causing them to increase fees or to attempt to sidestep these functions altogether. Nevertheless, the protection of brand standards has been a powerful force in keeping the brands in the management function for branded residences.

In instances where the brand does perform the branded residences management functions, a residences management agreement is entered into between the brand operator and the corporation, association or other legal entity created in connection with the governance of the project (the "Association").

In instances in which the brand does not manage the residential component of the project, a separate license agreement will govern the use of the brand marks and there will not typically be a fee for this right, although one can anticipate to be charged for out-of-pocket expenses of the brand in the administration of the agreement, which includes the burden of monitoring compliance with brand standards. These costs are addressed on a reimbursement basis in a management scenario.

Although most buyers of branded residences would likely have an expectation that they are purchasing a residence that will always be associated with, and/or operated by, the particular brand, this expectation is rarely assured, and the offering documents, if any, should disclose this risk. The possibility of the brand disassociating from what was purchased as a branded residence is a huge issue that has not yet been addressed in the courts of any jurisdiction that we are aware of. However, there have been a few lawsuits initiated addressing this issue. Clearly, developers and brands anticipate that the branding of a residence will result in faster absorption of homes and higher purchase prices. Purchasers are willing to pay higher prices based on a belief that the quality and experience that they associate with the brand will be found in the branded residence. Some of this is expected to be reflected in the residence itself, but much of it is to be reflected in the service standards associated with the residence. If the brand is no longer associated with the property, what are the rights of the initial (or subsequent) purchasers, particularly if the brand is replaced by an inferior or no brand at all.

- Finally, what about amenities such as golf, beach or dinner clubs? Will the club be branded and who will operate it? Will club membership be available to residents and guests of unbranded portions of the resort community or to non-residents of the community? Will royalties be due in connection with membership sales and will annual dues and other club revenues be included as general hotel revenues for the purpose of computing base management fees. These issues vary quite a bit from project to project. This is primarily due to the newness of these mixed-use projects and the lack of market information concerning the impact of these important decisions. One can expect greater clarity on industry norms with regard to these issues over time.

- **Whole Ownership with a Branded Rental Program**. Contrary to branded residences, whole ownership products (i.e., a for sale real estate product in which all of the interests in the unit are conveyed in a single transaction, as opposed to shared ownership as is found in the case of timeshare, fractional and private residence clubs) are designed and intended for a more transient form of occupancy. These units may be anything from high-rise condominiums to low density villas or townhome products. The owner is typically, although not always, permitted to occupy the residence on a basis established in the governance documents and the residence typically participates in a branded rental program whereby the brand uses the power of its reservation system to arrange transient occupancy of units on a basis similar to traditional hotel rooms. There are great jurisdictional differences in rental programs based on the local laws applicable to this product type. Typically, a project with branded rental residences will be subject to legal restrictions prohibiting rental by any other third party rental program operator. Most unique in this regard, are projects located in the U.S., offered in the U.S. or offered to U.S. residents. In each of these instances, U.S. securities laws wreak havoc with what would otherwise be a relatively straight forward business transaction.[4] The operation of a whole ownership rental program is the product of the governance documents for the particular portion of the resort and the rental agreement entered into by the residence owner and either the developer, on behalf of the brand, or the brand itself.

Rental Agreements

A contract between the unit owner and the party responsible for the rental program governs the use of a residence within a branded rental program and typically addresses the issues described below. The treatment of some of these issues is a function of the local law applicable to the project as well as the laws of the jurisdiction in which the real estate interests are offered.

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[4] This subject is, however, outside the scope of this article. Suffice it to say that as a result of the application of U.S. securities laws, U.S. programs do not restrict third party rental program operators or limit owner occupancy of units.

The primary issues addressed in rental agreements for short-term rental of branded units are: (a) the contract term, which varies dramatically amongst jurisdictions, (b) the allocation of rental revenues between the operator and the unit owner, after deduction of a certain specified fees, (c) the allocation of certain hotel-related expenses to the rental operator (such as reservations, housekeeping, staffing, administration, and accounting), (d) the allocation of certain residence-related expenses to the unit owners (such as reserves, taxes, homeowner's maintenance fees, residence maintenance and repair, and insurance), (e) the mandatory reserve allocation for capital improvements to the residence based on a percentage of rental revenues (usually 5% or 6%), (f) the obligation to maintain the brand standards within the unit, (g) the operator obligation to rent the unit based on a fair rotation system vis-à-vis other units in the program (and in many instances after rental priority is given to hotel dedicated guest rooms), and (h) the allocation of time for owner occupancy along with reservation procedures.

Control over the "guest experience" in short-term rentals is extremely important to the brands. Mechanisms to assure that the brand experience is delivered include brand prescribed furniture, fixtures and equipment ("FF&E"), appointments and consumable supplies, brand services such as housekeeping and in-room dining, and regular inspection and replacement of unit FF&E. Control over the interior of units is achieved through the terms and conditions of the rental agreement which require a percentage of the residence rental revenues to be placed in an FF&E reserve account controlled by the branded operator, for use in the upkeep, maintenance and refurbishing of the Residences in accordance with the brand standards. To the extent that funds in the FF&E reserve account are insufficient to maintain the brand standards, the residence owner is typically required by the rental agreement to fund such deficiency.

Use and Occupancy

Owner occupancy is sometimes limited by the governance documents. For example, local zoning and land use restrictions may limit the number of residential units, making it critical that the whole ownership units not be considered residential units. Most commonly, this is accomplished by restricting occupancy for uninterrupted periods of more than the legally prescribed threshold for residential occupancy. Frequently it is only the rental agreement that limits owner occupancy, and these restrictions apply only to units that participate in the rental program. In some cases, participation of all units is mandatory. In other cases, including almost all programs in the U.S., participation is voluntary. While it would appear reasonable to permit the unit owner to make his or her own decision concerning usage, a developer or brand will typically want to restrict owner occupancy in order to maintain a higher level of rooms inventory for transient guests.

Services

Occupants of rental program units, be it the unit owner or a guest, typically enjoy an array of services and amenities comparable to a traditional hotel room occupant. Owners are sometimes offered a discount for the use of these services and amenities.[5]

- **Shared Ownership (Timeshare, Fractionals and Private Residence Clubs)**. Whereas branded residences and units intended for rental programs entail ownership of the entire residence or unit, shared ownership products, as suggested by the name, entail a sharing of ownership of a residence or lodging unit. The more common types of shared ownership products (timeshare, fractional, and private residence clubs), have much in common in terms of legal structure. Nevertheless, the physical characteristics of the residences and the use rights associated with shared ownership differ dramatically among these product types.

Legal Structure

Broadly speaking, the asset acquired under a shared ownership regime is either an interest in real estate, commonly referred to as a “deeded interest” or a “timeshare estate,” or, as is more common in Asia, a bundle of contractual rights that do not entail a transfer of an interest in real property which is referred to as a “right to use” product. Within these two categories there are many variations, the most significant being described below:

  - Deeded Interests. A deeded interest or timeshare estate refers to (i) a right to occupy a dwelling unit for a recurring annual or bi-annual interval of time, along with (ii) a real estate ownership interest in the form of an undivided interest in real estate, an interest in a condominium or cooperative regime, or an interest in a trust.

  - Right to Use. A right to use interest or a timeshare license refers to a contractual right to occupy a residence for a recurring annual or bi-annual interval of time for a stated number of years, in the form of a license, lease or membership agreement.

    Regardless of the legal structure created (deeded or right to use), shared ownership interests are subject to a timeshare use plan which dictates the use and occupancy of the residences. Under the simplest use plan, the purchaser acquires the right to use a specific residence during a specific period of time (e.g., week 13 in residence 123). However, this simple use plan does not provide flexibility to a purchaser. As such, more flexible plans are typical,

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5 In jurisdictions in which the branded rental program cannot be offered as the exclusive rental program, branded services may be denied to owners and occupants who do not participate in the branded rental program.

allowing occupancy of a residence type (studio, 1-bedroom or 2-bedroom) during a period of time (1 week in high season), subject to advance reservation. This type of plan can take the form of a floating week system, or a points-based system. In a floating week system, a purchaser acquires a right to reserve a week in a type of residence on a first come first served basis. In a points based system, a purchaser acquires a certain number of points which may be used to buy occupancy rights or other goods or services. Under such a program each residence and occupancy time period is assigned a number of points. A purchaser in a points based system acquires a specified number of points each year which can be used or saved as specified in the "use plan".

Product Types

Shared ownership products are typically differentiated by the amount of time the residence may be used by an owner, the size of the residence, the price per square foot, the operating assessment, and the nature and extent of associated services. A typical timeshare product would consist of one or two weeks of occupancy per year of a one, two or three bedroom residence, with rental and exchanges permitted. A typical fractional product would consist of four to twelve weeks of permitted use of a larger residence typically having two to four bedrooms and the unused time would frequently be permitted to be deposited into a rental program. A typical private residence club (sometimes referred to as a "PRC") might provide for a similar amount of occupancy as a fractional product but the unit would be larger and more highly amenitized than the fractional product. It is less likely that an owner would be permitted to rent unused time under a PRC use plan as the private residence concept attempts to more closely mimic a private residence and limit the number of unfamiliar occupants.

Of the shared ownership products, timeshare is a slightly more common product found in the Asia Pacific market, with fractional and PRCs being somewhat rare, albeit hopefully more common in the future. The Marriott Vacation Club, a more dominant brand in the shared ownership space, has been involved in timeshare for approximately three years in mainland China and Southeast Asia and has focused on right to use timeshare during that period. Wyndham and Accor are also primarily focused on the timeshare end of the shared ownership market.

- **Destination Clubs**. Destination Clubs are generally non-equity clubs in which the member acquires a certain amount of annual guaranteed occupancy of the club's various residences, as well as the right to additional use on a space available basis. Destination clubs differ from right to use fractionals or PRC products in a variety of ways, including the tendency for fractional and PRC products to be a discrete portion of a resort built expressly for use as a fractional or PRC product, whereas destination club inventory tends to be a group of units located within a number of resorts not developed or owned by the destination club. Destination clubs are a relatively new product and one can expect some further definition of the product over time.

Destination clubs have had some adverse publicity in recent years arising from the widely observed bankruptcy of one the early clubs, Tanner and Haley. Similar to golf club membership programs, destination clubs may offer the return of a portion of the purchase price of the membership upon its surrender and reissue to a new member. Many destination club operators offer club memberships at different price points, with the more expensive club memberships offering some combination of more expensive homes and greater occupancy opportunities. Prominent examples of Destination Clubs are Exclusive Resorts and Quintess LRW.

- **Serviced Apartments**. Although not a for sale product, some mention of serviced apartments, also referred to as corporate apartments, vacation suites or extended stay product, is appropriate as these represent another lodging product that is increasingly branded by major hotel companies. Serviced apartments are common in Asia, where they serve as a furnished accommodation with known standards and a variety of services and amenities that are appealing to long-term visitors, typically business people. The market for serviced apartments has historically been dominated by a few large operators such as Ascott and Fraser, as well as Swire Properties Group, which has been successful in Hong Kong with its serviced apartments at Pacific Place. More recently, however, the market for the serviced apartment has expanded to service consumers at the budget level as well as consumers who desire the standards established by hotel operators in the higher segments of the chain scale. An example of a branded serviced apartment at the highest portion of the chain scale is Four Seasons Place, Hong Kong. Marriott offers its Marriott Executive Apartments in a number of Asian cities, including Bejing (with no associated hotel) and in Shanghai, where several floors of serviced apartments are the podium for a JW Marriott hotel.

  Absent the global slowdown in development activity, nearly all luxury hotel brands would be moving more quickly into this product segment as supply appears to be well below market demand in many market areas and development and management is quite similar to a traditional hotel. A typical serviced apartment project has the same legal structure as a traditional hotel, being an owner developer contracting with a branded (or unbranded) manager for the provision of development oriented technical services, pre-opening services and finally, operations management. At the point that the serviced apartment becomes part of an integrated mixed-use project, however, the issues concerning property covenants and restrictions, the careful coordination of uses, and the implementation of sophisticated legal firewalls between uses, become quite relevant.

  One can also expect to see increasing market segmentation in the serviced apartment sector as international brands bring their well established mid-market and budget brands into markets like Asia.

Planning the Mixed-Use Resort

A confluence of circumstances has resulted in the high degree of interest that exists with regard to mixed-use resort projects. First, pressure on the capital structures of resort projects frequently necessitates the inclusion of one or more for sale lodging products to defray land and development costs. Second, the brands have come to recognize that for sale products represent an important source of additional revenue and brand distribution, and one with a particularly large financial impact during the period preceding commencement of operations of the resort hotel or the branded for sale product. Third, branded services and experiences have gained importance to consumers in the increasingly time starved world. For these reasons, and others, each of the primary stakeholders in a mixed-use resort has gravitated to these branded products.

The process of identifying the particular product types to incorporate within a resort requires careful investigation and planning and a healthy respect for the lessons learned in other projects. Issues to consider include:

- The profile of the potential purchasers of each type of for sale product need to be developed. The socio-economic characteristics, as well as the likes and dislikes of the branded residence purchaser, are very different from that of a fractional purchaser and even more different than that of a timeshare purchaser.

- The feeder markets for each product type and for the property in general should be identified and the depth of the market for each product type, evaluated. For example, what issues exist with respect to access, roads, airports, and flight connections?

- An evaluation of the nature of the experience (e.g., type of amenity, quality expectations and exclusivity) and the price sensitivity, each as applicable to each population of potential purchasers and guests, must be made. How distinct will the guest/occupant experiences be within different components of the resort? Will people come together on the beach, in a clubhouse, at restaurants, at a spa, etc? How different must the programming be for the occupant of the branded residence and the guest of a rental program or timeshare unit?

- The amount of each product type to be developed must be considered with a focus on both absorption, necessary economies of scale, issues of exclusivity and the impact of more or less of one product type on the other components of the resort. How will a greater percentage of transient guests in the hotel, timeshare and rental program units impact the market for branded residences, golf club memberships, and PRC and fractional interests?

- The configuration of lodging units will impact the population of potential buyers and the balance between types of buyers (e.g., families vs. retirees vs. business travelers vs. young, hip and chic). Moreover, each demographic drives a different set of amenities (kiddie pools vs. health and wellness).

- Amenities branding is an important and complex issue. How will the residential owner investing a significant amount of capital in a club membership view a clubhouse that is dominated by transient guests, resulting in a very un-club-like experience? Will a golf club be open to outside members? How about during the pre-stabilized period during which facilities tend to be under-utilized? Branded residences may be a better fit for properties that include ski slopes, hiking trails or an urban environment, each of which takes the occupant outside the resort, as opposed to properties where a golf or beach club are the centerpiece of the "experience." In a golf oriented resort, it may be more appropriate to group transient uses such as hotel and rental program product with fractional ownership or timeshare. In a more exclusive setting, perhaps branded residential and PRC product or destination club product are more complimentary.
- The prospective purchaser's purpose and expectations in acquiring the for sale product. Are purchasers primarily acquiring a real estate investment, a vacation experience or a vacation home?

Project programming decisions are anything but simple and cannot be addressed in an exhaustive manner within this article. The ultimate selection of product types must be supported by well thought out market information. It should go without saying that a realistic understanding of the resort location and attributes is also critical. Many failed projects are the result of a developer that falls uncritically in love with a particular site. Realistically speaking, what differentiates one site from another? Will the location be the one that captures the enthusiasm of guests over the course of one, or perhaps a few visits, or is this the location that families chose to invest in as a place that will always attract their children and grandchildren? Is it sufficiently accessible to serve this role? Excellence in execution is critical but will rarely overcome inherent weakness in a site. Barriers to entry by competitive products are equally important.

A starting point, but only a starting point, to this analysis, is a market and feasibility study including advanced market research in the form of focus groups and other available techniques.

Once the product mix has been tentatively identified, there will be a need to further refine the characteristics of each product and carefully consider the inter-relationships among project components. This process is typically undertaken along with discussions with several potential brands and capital sources. Brand selection itself may result in an adjustment to the product mix.

At or about this time, the developer would also be expected to begin the preparation of legal documents, perhaps a carefully constructed outline until a later stage in the development process. Nevertheless, the ability to adequately demonstrate the legal structure, with its protections for lenders and brands is an important mechanism in building the credibility of the project and overcoming initial concerns that both brands and capital providers may have. Some of the legal infrastructure is described in general terms below.

Legal Infrastructure - The Offering and Governance Documents

While the license agreements and management agreements typically found in a branded project have been commented on above, a few additional points should be made concerning the offering and governance documents for these projects. Offering documents, typically not required in Asia, are a summary of the more important aspects of the project and the particular product being offered for sale. These documents may include discussions of risks inherent in the purchase transaction and, in the case of a rental program unit, investment proformas. A variety of relevant documents and agreements may constitute exhibits to the offering documents.

Governance documents[6] are the legal infrastructure upon which the project rests. The governance documents are covenants and restrictions that provide for such matters as the maintenance and repair of common elements of the project (roads, utilities and landscaping), impose architectural restrictions, establish permitted uses of various components of the project, create a right to impose assessments on all properties within the project based on criteria set forth therein, and address the rights to use and enjoy various facilities within the project such as clubhouses, golf courses, open spaces and other common elements.

If the foregoing are considered the master documents for the entire project, there may also be community or neighborhood covenants that impose additional regulation of property within a single portion of the larger project. Community or neighborhood governance documents are comparable to the master documents described above, but go into additional areas of more localized concern such as the maintenance and repair of, and architectural standards for, buildings within the particular portion of the resort. The community or neighborhood covenants may also address the product specific issues such as leasing restrictions, use rights, FF&E requirements and the like. In the case of shared ownership products, this document may be the actual use plan or may provide the basis for enforcement of the use plan.

In addition to the master and community governance documents, there will be rules and regulations as well as organizational documents for any Associations.

The brand is not typically a party to the governance or offering documents, as their involvement in the project is not perpetual. Certain brands allow the use of their brand marks on the cover of the offering documents in order to identify the branded project. However, most brands require that both the governance and offering documents contain a statement indicating that the brand affiliation is for a limited time, may be terminated by the brand or the developer, and that purchasers do not acquire any right to the brand names.

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[6] We use this as a generic term for documents that may be referred to differently in different jurisdictions. However, these are the covenants and restrictions that are typically registered or filed in a land registry so as to bind each owner of property within the larger parcel of property that is burdened by the restrictions.

In some cases, brands require that the initial purchasers execute a certificate at the closing of the acquisition of their unit or residence, acknowledging these matters.

Typical Issues and Overriding Considerations

Although mixed-use developments, be they large low-density beach or golf resorts, or urban skyscrapers not necessarily thought of as a resort, are not an entirely new concept, their complexity has grown dramatically over recent years. The product types have expanded, and issues associated with branding for sale offerings (be they real estate or right-to-use offerings) are frequently considered in the absence of either clear market standards, or even clear answers to a wide variety of legal issues. In the U.S., where there has been more mixed-use resort development experience than in most jurisdictions, the issues are bubbling up to the surface in a variety of resorts, sometimes in the context of litigation. At this time, however, few of the legal issues have been addressed by courts of law and even when that happens, it will take years to establish clear legal principles with regard to certain of the more complex issues. In the meantime, it is unclear how the real estate consumer will react to the practices established by the brands and the development community in the first generation of mixed-use branded resorts[7]. The following are just a few of the more challenging issues:

- Enforcement of Brand Standards. The mechanisms for the enforcement of brand standards are somewhat dependent on local law in addition to the specific terms of the governance documents. Frequently, the covenants and restrictions for the project (or a portion of the project) will require that properties be maintained in accordance with the standards established "by the brand that is associated with" the particular component of the project. Such a generic reference to the brand allows for the possibility of a change in the brand over time. The provision should also address the establishment of standards during any period during which no brand is associated with the project. It is important to note that the brand does not typically have the right to enforce this type of provision itself, and is dependent on a covenant by the developer to enforce these rights on behalf of the brand. In some instances, the brand is able to enforce its standards directly through its management function; however this right is dependent on the management contract being in place. In the case of products such as branded residential, the brand could choose to terminate its management function without terminating the branding and would then lose this direct right to enforce standards. In the end, the enforcement mechanism for brand standards is vitally important and needs to be addressed in a manner that is carefully designed in the context of the mix of products, management and branding of each, the ability of the developer to retain long term control, and the nuances of local law.

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[7] Moreover, most industry participants agree that they cannot know how and to what extent consumer preferences have been permanently altered by the dramatic economic reversal of the last part of this decade.

- Disassociation of the Brand. The problem of a brand leaving a project and the removal of its marks, its management expertise and its focus on brand standards, is a huge unknown[8]. Buyers of lodging products have presumably paid a premium for their purchase based on the branding. Some estimate the premium on branded products to be in the range of 25%. While any proper offering documents will disclose the risk of brand termination and acknowledge that purchasers have no remedies against the developer or the brand in connection with the de-branding, the effectiveness of these disclaimers has not been put to the test of judicial scrutiny. One can envision this issue being presented to a judge in the context of quite striking facts. For example, a residence or unit that was purchased at two times its then current market value, with a substantial premium having been paid for the branding, and the branding having terminated prior to or shortly after the plaintiff closed on the unit or residence based on the developer's loss of financing, the failure of units in other parts of the project to close or a lack of transient business in the hotel. It is possible that the premium placed on branded lodging products will shrink considerably based on growing consumer sensitivity to this issue. One can also envision a variety of financial mechanisms to better protect consumers against this risk, including the creation of a holdback of the branding premium for a stated amortization period, but these types of protections would meet with strong resistance from brands and developers. Ultimately, market conditions will influence the resolution of this risk.

- The Cost of Branding. While purchasers of branded lodging products understand the cost of spending a night in a branded hotel room, they may not appreciate how that translates into the cost of owning a branded residence or whole ownership branded rental product. These are all first generation products, and very few have been operational for an extended period of time. It would be reasonable to expect that given the real estate bubble we are emerging from (resulting in a high basis in these units and residences), the industry-wide decline in hotel RevPAR, and the intense pressure that resort developers find themselves in, the next several years will not be kind to these projects. In this context, issues of costs allocations among project components can be expected to be hotly debated and thereafter, litigated. Like much else in the mixed-use resort world, complex allocation methodologies have been first time efforts for many developers and consultants alike. Moreover, there are many instances in which lack of effective communication between the lawyers and the personnel responsible for preparing budgets has resulted in a substantial disconnect between the budgets and the legal documents. The coordination of budgets and expense allocations has been an area in which far too little attention has produced significant exposure to all stakeholders. Separate and apart from the confusion and mistakes found in the budgeting process is the reality that of the three primary stakeholders in

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[8] Typically, all brand affiliations within a resort are cross defaulted with the hotel management agreement. Therefore, a termination of the hotel management agreement typically results in a termination of all agreements. Such a termination may occur based on the failure of the brand to meet performance standards agreed to by the brand, through a wrongful termination by the developer or the brand, or by virtue of other circumstances outside the control of either party.

the budget and cost allocation equation (developers, brands and consumers), only one is not at the table when the governance documents and budgets are prepared, this being the purchaser of the branded real estate. Whether intentional or not, developers are notorious for underestimating in offering materials, even straight forward condominium budgets. Consequently, one must anticipate that with the costs associated with branding new residential products being somewhat unknown, there is some concern in the market regarding the price sensitivity that purchasers of branded real estate will have on a prospective basis. The answer to this question will impact the pricing of resales of these products as well as the depth of the market and pricing of new product. This issue is less problematic in the case of branded residences, where there is no unknown variable as to revenue to be generated from rental activity and much of the branded experience is comprised of controllable à la carte services, than is the case with whole ownership rental products, where the opposite is true. Shared ownership is also less problematic as this product has a longer history.

- Compatibility of Project Components. Much has already been said about establishing complimentary mixes of lodging products and amenities. While each project is different, experience in existing projects will undoubtedly result in a variety of best practices that are not always apparent to a first time developer of mixed-use resorts.
- Resales. Resales in the shared ownership market are generally understood to be a significant problem in the case of timeshare, and an unanswered question in the case of fractionals and PRCs. Resales are similarly an unanswered question in the case of whole ownership branded rentals, although actual operating experience should be all that it takes to resolve that issue. This resale experience will, of course, be fed back into the pricing assumptions for new product. The same feedback loop can be expected in the branded residential market.
- Regulation. Like all new products, regulation will catch up with this business over time. Regulation will be based on different policy approaches in each jurisdiction, as we have seen in the case of shared ownership products. It is worth noting that after some forty years of timeshare activity, regulation is just coming to many parts of the world.

Potential Pitfalls in Asia

The following are a few areas of particular concern when structuring a branded resort real estate project in Asia:

- Shared Ownership (timeshare, fractionals and PRCs) is a relatively new concept in Asia and one which may to face cultural barriers with Asian investors. This is not helped by the negative experience of investors in such products in other jurisdictions.
- Real estate laws vary from country to country in Asia, and there are restrictions or barriers to fee simple ownership in many countries, for example:

- Vietnam and Thailand both restrict foreign ownership of land although both jurisdictions have been successful destinations for branded real estate products. Innovative solutions are required to overcome these restrictions, and include such things as cooperative ownership, the transfer of leasehold interests and the sale of right to use products.
- The property in The Cotai Strip in Macau, which is slated to become the "Las Vegas of Asia" and which would appear to be a strong potential destination for branded real estate property, has land use restrictions contained in the land grants to resort developers which prohibit for sale real estate product within the lands proposed to be developed as resorts. Again, innovative solutions will be required to overcome these restrictions. One can anticipate that these may also include cooperative ownership, the transfer of leasehold interests and the sale of right to use products.
- Hong Kong, mainland China and Thailand prohibit the freehold ownership of real property, such that, again, cooperative ownership, the transfer of leasehold interests and the sale of right to use interests may be utilized as an alternative to the sale of deeded freehold interests.

Conclusion

Branded real estate products have seen a huge growth spurt during the very forgiving real estate cycle that we have recently left behind. That activity is now undergoing an equally dramatic shakeout based on the unparalleled recession we find ourselves in across the globe. All of this will likely result in a substantial learning experience for all stakeholders. This experience will clearly need to be incorporated into the next generation of mixed-use resorts and may have the effect of significantly accelerating the incorporation of lessons learned.