Possible Timeshare Product Structures Within China's Legal Framework

by Michael Qu, Law View Partners Law Office

For many years, developers who hold quantities of recreational real estate inventory (whether high quality apartments or villas) or who may be about to develop a new resort project, are always thinking of innovative sales models to monetize their inventory while tailored to the holiday needs and preferences of affluent families. It is particularly true in China when the country started to place emphasis on the "use-right" over "ownership and investment" of residential and commercial properties.

Timeshare has been frequently considered as an option by some Developers and hotel owners given its long-established history and financial attractiveness. The benefits are obvious: it creates a platform to generate a number of very specific revenue streams for the Developer, including a higher yield on the real estate, the ability to earn profits through providing consumer loans to their buyers and highly profitable resort management operations from the provision of all necessary management and hospitality services to their Members, who will, over time, become a long-term captive customer base.

Timeshare product is structured in a variety of ways, depending upon the jurisdiction in which the projects are located. Within the USA market, timeshare interests will usually comprise a right to the use of vacation accommodation, linked to a deeded real estate interest. In Europe and elsewhere, timeshare is more often structured as a "right to use" which entitles owner to use one or more weeks in the resort's accommodations together with the use and enjoyment of the resort's amenities whilst in residence. The "right to use" is usually conceptualized as a Club Membership. The unencumbered ownership of the timeshare accommodation units is held under the control of an independent Administrator to guarantee the Club Members' ability to exercise their future occupancy rights.

However, in China, using an independent Trustee to hold or control the unencumbered ownership of the Club's accommodation assets has encountered difficulties mostly due to certain restriction on real estate transactions and lack of tax pass-through policies. In order to adopt a mechanism to provide an assurance for the Club Members that their future rights to use, occupy and enjoy the Club accommodations are secure for the full term of the membership purchased, some innovative structures are considered in recent practices. Below is an introduction of some possible structures:

Co-ownership of Condominium

Deeded interest is always the most simple and straightforward way in favor of the protection of buyer's rights. It is the basic principle in China that real property right entitled and protected upon registration; one property title can be severally co-owned by different individuals; co-owners can enjoy the ownership based on their proportion and can only make decision on a joint basis. Although not very commonly adopted, there are practices that developers structured the buyer's interest in terms of 1/12 of strata title of a condominium, which may be placed on an internal or external platform for exchange of diversified accommodation options.

However, there are a couple of challenges to consider and address: whether land use right is possible for selling strata titles to individual buyers; the cumbersome procedures going with registration authorities; establishing a homeowners governance policy not only practical for product maintenance but also in compliance with the property related laws.

By far, this structure has not been very successfully implemented largely due to inappropriate marketing approaches taken by developers, who either sell the product in a traditional way as they sell residential apartment, which ends up in many buyers treating it as an investment, or haven't paid enough focuses on creation of prestigious services and amenities for timeshare owners. As a product structuring option, however, it is still worth considering as deeded based shared ownership is apparently one of the most secure ways for consumer protection.

The "Usufruct" Concept

The right-to-use concept is more commonly adopted due to its flexibility and low entry barriers. However, as discussed above, unable to secure the unencumbered ownership of the timeshare accommodation at the hands of an independent administrator will make the product type less reliable.

Consumer protection has been the greatest concern. In many countries where timeshare legislations are developed, it is often required for Developers to observe minimum regulation to protect the consumer's rights, in the aspects such as financial disclosure and assurance, compliance in sales and marketing activities, escrow account and recession period, etc. In China, in absence of a special timeshare legislation, consumers must count on the Developer's credibility of keeping the promises it made in the sales and purchase agreement.

This has kept some developers from tapping into the industry as trust from the customers may not easily be built. Those hotel owners or operators who hold sizable resort portfolio and has built up a recognized brand, however, might have better chances to consider this model. One major developer in China has established a club-based timeshare plan catering for the elderly customers. Its portfolio includes hotel properties in multiply cities—some are self-owned, and some are included from partners in cooperative way. Pricing at around RMB200,000 (approximately USD28,500) for a usage term of 10 years, it's entitlement to the buyers is similar to a typical fractional ownership or PRC, i.e. 30 overnights stay in chosen hotels and enjoyment of various amenities, some of which are uniquely designed for elderly person with health and wellness focuses. This is a very interesting example illustrates what localization and innovation can be made when putting a global practice into the domestic environment.

Share-based Structure

In a typical share-based structure, the Land Use Right of a property will be held by a limited company with 2 classes of shares: Class A voting shares to be held by Developer and Class B non-voting shares to be sold to shared ownership rights buyers. Owning the shares of the holding company enables buyers to have indirect control over the timeshare property.

The corporate structure is a common alternative of strata title in some countries, such as the U.S., as it has been well regulated and the owners' right within this mechanism is both protected and refrained to some extent. However, it has been seldomly adopted in the Chinese market, mostly due to the stringent regulatory oversight over private fundraising. Although not being clearly defined and regulated, soliciting prospective buyer to purchase corporate shares in a Special Purpose Vehicle (SPV) holding the timeshare properties may be regarded as fundraising from the general public. In some countries, activities alike are subject to securities laws, which has been a big barrier for market entrants. In China, if such activities are regarded as fundraising of an investment nature, it shall be subject to various restrictions which is hard to be satisfied by a timeshare product.

As such, some will consider to structuring the corporate in an offshore basis so that buyers may hold the shares of a foreign company corresponding to their product entitlement, which is governed by laws in an overseas jurisdiction. This can be an option for international players who has structured the property holding company on offshore basis, although there are still issues (e.g. foreign exchange control for Chinese individuals purchasing the offshore shares) to think through.

Consumption Trust Product

Consumption Trust Product is a newly developed trust scheme that can be issued through a PRC trust company. It is a blend of a finance and consumption product for consumers. In other words, consumer will be compensated with a service product in return for purchasing the trust product, and the trust company will be entrusted to use the monies paid by the consumer to buy service products from third parties. In practice, part of the monies will be used to purchase service products and part will be managed by the trust company for secured investment purpose (e.g. loans to developer for specific projects).

In this structure, a Trust Company will initiate a trust scheme and engage a sales force, usually a bank, to sell the trust product of the scheme to individual consumers. As a return of enjoying service products purchased by the Trust Company, consumers will become members of the Club, where they can enjoy interest of points, which is provided by a Club Company.

In order to provide consumers with the Club service (i.e. use and enjoyment of the Club properties), the Trust Company will pay the developer for inventory, which, through an Allocation Contract, will be assigned to the Club Company.

As an option, the trust company can lend part of the money collected from the consumer to the developer and set up a first-priority mortgage upon the target property in order to create security over the Club property.

While the timeshare industry developed very slowly in China, the consumption demand from domestic consumers has seen significantly incremental in recent years. To adopt a product structure attractive to the consumer as well as in compliance with China's regulatory environment requires innovation within the industry which has not been experienced elsewhere. Carefully walking through the pros and cons of the above options and designing one suitable structure for your own product will be an interesting journey for every developer to dive into.