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Branded Residences – Towards the Three Way Win

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Introduction

According to 19th century Scottish journalist Charles MacKay, author of *Extraordinary Popular Delusions & the Madness of Crowds*; "Men, it has been well said, think in herds. It will be seen that they go mad in herds, while they only recover their senses slowly, and one by one."

In the current tumultuous world of residential real estate, this claim appears to be holding true. Many of us are now engaged in a new form of crystal ball gazing that has to deal with the absence of those conveniently positive growth curves that became the common tool of speculators and developers in forecasting the future. However, downturns are common place in business and it is how you come out of one that is the real test, rather than how you caught the wave in the first place.

If MacKay was right, we will all come out of this economic meltdown one by one and based on our individual merits, but, as also identified by business writer James Surowiecki, the wisdom of crowds is not to be ignored, especially when the particular crowd involved is a group of 150 final year students at the Ecole hôtelière de Lausanne working on the latest EHL Strategy Challenge. Co-organised and moderated by the authors, the theme this year was "The Future of the Shared Ownership Industry in Europe" and the students were tasked with forecasting the future of the Timeshare, Branded Residences and Fractional Ownership segments, including private residence clubs and destination clubs.

This article focuses on Branded Residences which have emerged in recent years as perhaps the archetypal example of blending hard-nosed real estate investment with that elusive concept, "lifestyle". If "lifestyle" means simply "the way that a person lives", then Branded Residences reflect a new way of living for cash rich and time poor HNWIs, the main target market for these properties across the globe. Owning several private residences is not a new phenomenon for the elite. However, as was made very clear by the results of the EHL Strategy Challenge, the forecast growth of the HNWI sector remains one of the few bright lights in the tunnel of economic recovery, especially when one looks at newer markets like India, Russia and China.

The business model is simple enough. Build high quality residential real estate in very desirable locations and then integrate branded hospitality services (and probably a hotel) via an agreement with one of the growing list of players in the field (e.g. Fairmont, Four Seasons, Jumeirah, Kempinski, Mandarin Oriental, Ritz Carlton, St Regis, Wyndham). Finally (or preferably before you start building) persuade individual investors to buy the properties at a significant premium above the price of "equivalent" non-branded real estate (if you can find some, of course).

For the time being, branding in this context refers to hospitality branding. Although Mr Armani is breaking into the market with his own lifestyle statement, there is a good reason for this. While we would not necessarily buy a hotel branded suit, we would rather put our trust when it comes to hotel service in people who dedicate huge resources to developing standards and training staff; in fact the invisible but indispensable side of the hospitality business. It is not enough to build a great apartment.

The result? Well, in theory three groups of happy people, a real Three Way Win: Developers with cash in the bank more quickly and more profitably; branded operators with a new source of management revenue and, perhaps more appealing, royalties from the use of their good name; and owners with a gilt edged investment in branded residential real estate with the promise of long term investment protection and, for some, the possibility of rental

Summary

A review of the Branded Residence sector based on the results of the 2010 EHL Strategy Challenge at the Ecole hôtelière de Lausanne when 150 students set about forecasting the future of Timeshare, Branded Residences and Fractional Ownership.

Comments

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revenue from periods when they are not in residence.

It is sometimes said that true exclusivity, and therefore premium value for Branded Residences, precludes the existence of a rental programme, but never forget the ability of the HNWI to recognize an opportunity to make money, especially when the motivation comes from tax planning, as is the case in many jurisdictions around the world.

It all sounds perfect, but the reality is that achieving a properly balanced result is far from easy and in the coming years the continuing lack of development finance, coupled with a more risk-averse attitude from investors, will put even more pressure on the ability to satisfy all three groups.

If the HNWI segment continues to hold fast, the ability to develop truly special properties will be the key to getting the attention of these people. This means finding projects that are set for the long haul and these are more likely to be found in the safe havens of the real estate world: the global gateway cities and those few recreational destinations that have already matured and where prime real estate is in short supply.

There was clear consensus about this from the EHL students in their Strategy Challenge reports; put your money on London, at least for now, but don’t lose sight completely of opportunities further East, especially as that is where your customers will be coming from.

Together with the golden rule about location, financing is the other key to success. Branded Residences are not (and probably never were) about speculative investment in secondary residential property aimed at short term gains; that arena now contains the severely damaged remains of many badly-conceived projects. There are still some gems out there that will need serious ”recalibration” and imaginative mezzanine financing solutions, but the high returns required by equity investors make the financing of genuine Branded Residence products very difficult, especially as off plan sales have become an exceptional answer to the question “If I build it, will they will come?” We cannot all have projects like One Hyde Park, but it is something to aim at.

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