

**A STUDY ON THE CONDO HOTEL CONCEPT
AND ITS INTRODUCTION TO KOREA**

By

Kwangsup Lee

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
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ABSTRACT

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The condo hotel concept has been booming in the U.S. and is now spreading across the world. This concept is hardly new and its beginning goes back to the 1960's with ups and downs thereafter. Basically the concept works in a way that condo hotel owners can use their units whenever they want and can profits by putting them in rental programs managed by world's renowned hotel operators when not in use. The owners share the profits with the operators and their units are well maintained by the operating companies that make it easier for them to own second homes. For all the fancy advantages, most condo hotel projects in earlier times had failed because developers had emphasized too much on the profits generated from the rental program to attract as many individual investors as they could. When the owners realized that the actual outcome did not meet their expectations, a chain of law suits against the developers caused chaotic results and the condo hotel concept was abandoned for decades since then. The condo hotel concept surprisingly returned to the lodging industry in 1990's and it was so successful that it has been playing a role as a pulling factor for the entire hotel business. This study will analyze how the concept is different from that of an earlier one and what the success factors are.

Judging from the background of condo hotel occurrence in the U.S., the concept will soon come into existence in Korea as the needs of owning second home are arising with accumulated wealth and increasing spare time. Even though the condo hotel concept would be useful tool to provide Koreans with affordable second homes, without proper measures, same chaotic results as in the case of the U.S. would appear in Korea. This study will present matters that require attention and seek to modify the concept to better fit the Korean circumstances.

Dedicated to Myung Chun Kim

TABLE OF CONTENTS

I. INTRODUCTION	1
II. Analysis of the Condo Hotel Concept in the U.S.....	4
A. Condo Hotel Overview	4
i. Overview	
ii. Other Different Concept	
iii. History of Condo Hotels	
iv. Benefits and Challenges of Developing Condo Hotels	
B. Business Structure	14
i. Development Types	
ii. Management and Operation	
C. Pending Legal Issues	18
D. Development Status and Cases.....	21
E. The Key Success Factors and Outlook.....	36
i. The Key Success Factors	
ii. The Outlook	
iii. The Unknown	
III. Introduction of the Condo Hotel Concept to Korea.....	42
A. Introducing the Condo Hotel Concept to Korea.....	42
i. Overall Market Situation	
ii. Similar Cases in Korea	
iii. Approaches to Introducing Condo Hotels	
iv. Fostering Condo Hotel in Tourism & Leisure City (TLC)	
B. Lesson from the Experience of the U.S.	54
i. Between Lifestyle and Investment	
ii. Enactment of Regulation	
IV. Conclusion.....	58

I. Introduction

The condo hotel business is the hottest trend in the U.S. lodging industry. By uniting the public's desire to invest in real estate with the travel industry's quest for new properties, the condo hotel has reinvigorated the hotel construction business and begun altering the skyline of cities such as Miami and Las Vegas.¹ It is so popular that in some cases, condo hotels sell out before construction is even begun.

Even though the concept of condo hotel is hardly new and dates as early as the 1960's, little research and historical data are available. That means the people who are interested in investing in condo hotels should pay attention on their own to the rental incomes and possible appreciation which are two major motivations attracting investors.

The reason why condo hotels are so popular in the U.S. is attributable to its peculiarities. The Baby Boomers are in their peak age of disposable income and already comprise the single largest group of homeowners. During the period from 2001 to 2003, the number of people in the 55-to59-year old age group grew by 1.8 million.² Their active and dynamic retirement lifestyles move them to acquire a second home and condo hotels, a hybrid lodging concept. Since many boomers view second homes as their eventual primary residence, retirement community developers, hoping to cash in on this market, are changing their business models to reflect boomers' penchant for luxury and

¹ Christopher Palmeri, "Checking out and into condo hotels", The BusinessWeek, December 10, 2005

² John Montgomery and Kevin Holt, "The differences between traditional lodging development and condominium hotel development", Horwath Hospitality & Leisure LLC, January 28, 2005

an active lifestyle.

Changes in travel and vacation patterns; an aging baby boomer generation creating a growing second-home demand; and a post-9/11–related desire to stay closer to home have spurred the reemergence of the condo-hotel as a real estate, rather than an investment, product. Condo-hotels can stand alone or be combined in mixed-use urban or resort projects to provide significant benefits to hotel owners and operators, and condominium purchasers.

A condo-hotel needs to be a hotel, whether operating or newly developed, but it does not have to be a condominium. It usually is a product where hotel improvements have been subdivided into condominiums. However, creating a condominium form of ownership is sometimes not allowed because of land use restrictions. In these cases, the land can remain undivided, and undivided interests in the entire property can be structured to create the rough equivalent of a classic condo-hotel.

What makes a condo-hotel a viable economic project is the availability of a rental program. Condominium purchasers can make their units available for rent as part of the hotel operation in exchange for a share, and, sometimes, for almost all of the units' rental proceeds. It is the combination of the condominium interest together with a rental agreement tying the condominium interest back into the hotel that defines the modern condo-hotel project.

Condo-hotels based on condominium regimes created under state laws follow a similar structure, and typically include both commercial units, such as the hotel operational areas and restaurants and bars, and residential units, such as guest rooms. This mixed-use structure makes it much easier for the owners of the

commercial side to control the overall project, through the condominium owners association, than in the case of a purely residential condominium project.

The overall market situation in Korea would be different from that of the U.S. but certain similarities exist such as low interest rate, the demographics, increasing demands from domestic and foreign tourist, etc.

This study will focus on finding benefits from introducing the condo hotel concept to Korea and its accompanying legal and institutional issues.

II. Analysis of the Condo Hotel Concept in the U.S.

A. Condo Hotel Overview

i. Overview

The concept of condo hotel is to own a luxury vacation home at a world-class resort while receiving rent revenue whenever they are not using it. It began in places like Miami beaches and Fort Lauderdale and is spreading into Las Vegas, Chicago, New York, the Caribbean, Dubai, etc. Condo hotels are usually large, high-rise, luxury four or five-star hotels operated by the luxury brands like Four Seasons, Ritz-Carlton, Starwood, Clarion, Conrad Hotels, and Le Meridien. Condo hotel units typically range from \$300,000 to well over \$1 million. In New York a three-bedroom with a maid's room and library of the Mandarin Oriental costs at least \$12 million and condos in the Ritz-Carlton New York range in price from \$12 million to \$ 28 million.³ Condo hotel expenses are determined by the mutual rental agreement but usually the hotel operator pays for most operating expenses and the condo hotel owner pays the real estate taxes, insurance and capital improvements.⁴

The current boom in condo hotels is driven by an unprecedented alignment of the economic interests of developers, consumers, hotel operators, and lenders. For hotel developers, the condo hotel model is a

³ "Five-Star living at condo hotels in Miami, Boston, San Francisco", Investment Guide, May 2004

financing bonanza. Construction debt for hotel projects typically runs 50 to 60 percent of cost. When condominiums are added to a hotel project, equity credits earned through condominium presales can provide debt financing approaching 90 percent loan-to-cost leverage. Developers are achieving significant front-end profits on the sale of condominium units in this scenario. And because the “hotel amenity” component creates a 15 to 40 percent premium value over the sale price per foot of comparable units, developers are also keen on the condo hotel model.

Consumers, particularly baby boomers nearing retirement, have an interest in owning real estate for both personal reasons and investment purposes. Owning real estate in a resort location, with hotel-style amenities and conveniences that are provided by a condo hotel, can be an attractive option. Add the investment potential—particularly through appreciation—and the possibility of defraying costs of ownership by renting the units out as hotel rooms, and it becomes easier to see why boomers are buying them. Also, the condo hotel has become a favored exchange property to effect tax-free exchanges under Internal Revenue Code Section 1031 and to facilitate the enormously popular tenancy in common (TIC) market.

Most hotel operators are happy to have a new supply of properties with which to expand their brands and to generate fees from the management and franchising of the condo hotels. They may also earn additional fees from renting out the units placed in the hotel rental management

⁴ Condo Hotel Center Website, www.condohotelcenter.com

program and for managing various condominium home owner associations (HOAs). They may even participate in royalty fees derived from licensing their names to the condominiums and collect a percentage of the sales price of units sold.

Lenders are finding the financing of condo hotel conversion and development projects attractive because the presales of units eliminate substantial risk during the construction phase. Typically, such projects have a fast payoff as the condominium units are sold, transferring the lending risk to the mortgagee for the individual unit holders.

ii. Other Different Concepts

- Conventional Condos

Condo hotels have more amenities and luxury-hotel-level services are available whereas condo owners would be responsible for their own housekeeping and unit upkeep. The owner of the condo unit has the option of renting out its unit when not in use but the owner would likely be responsible for finding renters, preparing the unit for those renters, and collecting the rent. Oftentimes, the condo association's approval may be required. The owner would keep 100% of the rental revenue.

- Hotel residences

Hotel residences are residential units that are a part of a hotel, usually one that is affiliated with a luxury hotel brands. The unit

sizes can range from as small as 800 sf. to as large as 4,000 sf. In urban locations, the residences are located on the upper floors of the hotel; in resort settings, they are generally located in an exclusive area within the resort complex. The unit owner lives in the unit full time or uses it as a second home. The residences sell at a higher premium because of the prestige of the associated hotel brand and the ability to use the hotel's amenities and services, including the restaurant, recreational facilities, spa, room service and so forth.

Unlike hotel residences, the units are placed in a rental program during the time that the owners are not in residence.

- Fractionals

The rental program applied to condo hotels are not usually applied to fractionals. Condo hotels are typically studios, one and two bedroom units, but fractionals are typically luxury 2-5 bedroom private homes. But the key difference is that the owner of a fractional can use it for a set number of days (usually no more than 90 days) whereas there's no specific limitation on using condo hotels.

- Private Residence Clubs

This concept is akin to the fractional ownership model and operates at its most exclusive end with costs to match. In the USA hotel groups such as Ritz-Carlton and St. Regis are active in this area. The investment, which is for a fixed number of days-usually

somewhat fewer (averaging 1/7th-1/8th fractions of a year-i.e. 6-7 weeks) than traditional fractional ownership-operates in a manner similar to membership of an exclusive club. These developments – again as with fractional ownership – tend to be smaller and in ultra-attractive destinations. The target market is those with high incomes and high liquidity. Sales and marketing costs are quoted as representing about 30 per cent of costs, compared with traditional timeshare's 50 per cent.

- Timeshares

Prices for timeshares are much lower than condo hotel prices because the price is for only one or two weeks of usage. Like condo hotels, timeshare owners can place their units in a rental program and split the revenue generated with the property's management company. It's only one or two weeks per year of allotted weeks.

- iii. History of Condo Hotels⁵

Originally, condo hotels were conversion projects from 1950's-built Miami Beach hotels in the early 1980's. Priced at under \$100,000 then, people bought them and used them as their weekend pool/beach hangout. Most of the sales were to locals. Then the tax laws changed in 1986, preventing buyers from using condo hotels as a tax shelter any longer. They fell out of favor until the late 1990's.

⁵ Condo Hotel Center Website, www.condohotelcenter.com

About a few years ago, the owner of an apartment building called the Mutiny in Coconut Grove, FL, converted his property and sold off its units as condo hotel rooms primarily to his people back home in Brazil. He was so successful that he increased prices 10 times before selling out. Other developers watched and learned and before long, they followed his successful examples. First there was the Bentley Hotel on South Miami Beach, and since then the market has grown dramatically, The new condo hotels differ from those earlier models in size, facility and price. They are typically bigger and have kitchens, more amenities, and usually have big named franchises tagged with much higher price.

iv. Benefits and Challenges of Developing Condo Hotels

Perhaps the greatest satisfaction in the real estate industry is that a single transaction can produce so many winners. Properly structured deals can offer up rewards for buyers, sellers, developers, lenders, consumers, builders, managers and operators, communities, and entire local economies. On the flip side, poorly structured deals often end up badly for all involved and get played out in expensive litigation. This is the context in which the industry must approach the current condominium hotel boom.

Developers, lenders, and other participants need to be protected against the inevitable fallout, as a badly structured condo hotel regime can have a bad impact on the hotel operator, the hotel brand, the customer, and

array of financial players—all with a stake in the project. A successful condo hotel project demands that intricate legal and operational threads, each representing the competing interests of numerous parties, be woven together. A tightly woven deal involves such complex structuring that even the most sophisticated of dealmakers can miss the many-layered details in their rush to participate in this profitable wave of development. Yet, it takes only one pulled thread for this delicate project tapestry to unravel.

However, there are some drawbacks. The legal structure, design, construction, marketing, and hotel operation all affect one another. Seemingly simple changes in one aspect have a ripple effect on all the others. Throw in the concerns of hundreds of individual unit owners and there can be a potential minefield of problems. Once there is a rend in the overall fabric of a condo hotel deal, it can be impossible to mend because consent may be required from some or all of the divergent stakeholders.

Developers can refer back to the thorny legal issues surrounding the early timeshare market and apply those lessons when structuring condo hotel deals. Further, many traditional condominium developers entering the condo hotel arena know more than they probably care to know about construction defect litigation. The adverse impact of these concerns will be mitigated if deals are carefully structured on the front end.

Developers need to be hyper vigilant in the marketing of for-sale units in a condo hotel project. If sales and marketing representatives are not properly trained and monitored, they can trigger liability under

securities law that could ultimately wipe out a developer's potentially heady profits.⁶

Benefits⁷

- The Developers

The condo hotel structure offers a number of potential benefits for the developer. First, it provides a method to help finance the development of hotels; the sale of units gives the developer an assured source of revenue to repay a portion of the construction loan upon the completion of the hotel, and the closing on the sale of the units. Additionally, a developer can benefit by marketing the hotel amenities to a buyer.

Developers of successful projects generally can obtain construction financing without reaching the lending threshold of 50% presales for a planned condominium development (along with a 20% down payment on the loan amount). Developers of condo-hotel projects are attracted to this development approach due to their ability to quickly "monetize" the management function of the property. That is, the sale of the hotel management opportunity is sold upfront during the sell-out phase of the residential condominiums, the developer may be able to receive rental revenue from the completed (and sometimes unsold) units being rented to hotel guest.

- The Owners

Condo owners purchase a condominium in a world-class hotel or resort

⁶ Jim Butler and Guy Maisnik, "Condo Hotels", Urban Land Institution, 2005

and then use their condo hotel unit whenever they like. By capitalizing on a hotel's national affiliation, reservation system, brand recognition and management expertise, unit owners are more likely to receive a higher level of rental income through a rental pool agreement with a recognized professional operator, despite having to share a portion of their unit's revenues. The condo hotel management company takes care of renting, cleaning and maintaining the unit. It's hassle-free, luxury vacation home in a fantastic destination and generates rent revenue that offsets its maintenance costs. Also it's an investment with great potential for appreciation.

- The Hotel Operators

The operator actually owns some real estate, which is similar to owning a hotel outright, but since the operator owns only the property that is directly related to its functions as a hotel operator, it maximizes its return on investment by a reduction in total overall dollars invested on its part. Additionally, the manager is essentially granted a long term management contract for the property since its purchase of the hotel function real estate imputes a long term management agreement with the individual condo owners. This ownership of the property allows them an unwritten long term contract with no specified termination date.⁸

⁷ Anwar Elgonemy, "Expanding the options for lodging development", Jones Lang LaSalle

⁸ Gibbs, Brian Charles, "Condo-hotels: in New Orleans?", Columbia University, 2003

Challenges⁹

- The Developers

Developers must ensure they, and their investors, enter into the deal knowing their exit plan and how they foresee the project proceeding. The following list of questions is a sample of what a prudent development team should be asking themselves. (1) Does the condo hotel developer expect to make all of its profit on the front-end sales of the units, or is it expecting to have value and cash flow from the residual hotel? (2) What support, if any, will the developer lend to the project if cash flows in the cyclical hotel business run short, or if capital is needed to maintain the property? (3) What capital calls and limitations are the homeowners associations (HOAs) subject to in order to support the project? (4) What balance of hotel operator concerns and unit owner freedom maximizes the value and profit of the condominium program?

- The Owners and Operators

A recurring theme in any discussion about condo hotels is their complex operating structure. The hotel needs to be able to handle the operator's particular market segment and the hotel operation needs an adequate supply of rooms on a predictable basis. The operator should be experienced enough to be able to handle the fluid rental pool. By knowing how many of the condominium units will be available as hotel rooms and when will allow the operator to accommodate paying visitors

⁹ Reynolds, J. Chadwick, Condo hotels: a review of current trends and a proposed conversion at a Vermont

and keep owners happy by having their unit ready for them when they want it. An example would be one hotel that sends letters to owners notifying them that a busy holiday is coming up and they should not expect to come in at the last minute and have their unit available.

Other condo hotels keep rolling armoires with owner's clothes in them so should there room be rented out they can simply roll the armoire into an available room. An operator should also be able to know how to handle large group and if there will be enough hotel business derived from rental of rooms to support the level of food and beverage unit owners will expect. Another key consideration is how the operator equitably allocates room rentals and how to handle unit owner who find that their units are less desirable or produce less income than hoped.

B. Business Structure

i. Development Types

There is a mix of condo hotels that are newly built from the ground up and those that were originally hotels and have been upgraded and converted into condo hotels.

1. Condo Hotel Creation

Today, most of hotel development projects in the U.S. feature a condo hotel concept in the master plan. It is no

exaggeration to say that the booming condo hotels are actually pulling the entire hotel industry. Especially hotel developers are encouraged to jump into the condo hotel projects with diminished financing burden resulting from the pre-sell portion of hotel units.

2. Condo Hotel Conversion

If an old hotel is losing ground to its competitors, it should be either updated or franchised by renowned hotel management companies. As these cost significant money, the hotel owner can finance the upgrade by increasing his debt or putting up more of his own money by selling off units as condos to individual buyers. Also land in prime locations is so limited and costly resulting in more condo hotel conversions. Another benefit is the speed in which a conversion can be done. Most conversions take six to nine months to complete whereas a new construction condo hotel could take up to two years.

Converting existing hotel properties to condo-hotels requires understanding the entrenched interests of the local government in which the properties are located. A primary issue for local jurisdictions is preserving the transient occupancy tax (TOT) on rentals and the loss of this tax in the event that condominium owners elect to occupy their units. Local jurisdictions have developed a number of ways

to deal with this issue, ranging from leaving it alone in exchange for significant new capital investment into the hotel properties, to imposing in-lieu fees, equivalent to any approximated loss of TOT, on any approval of a condominium conversion. In some cases, local jurisdictions actually tax unpaid use by condominium owners based on an average daily rate formula as if the unit were rented to the public. They can also impose conditions to approval of a conversion, including, but not limited to, TOT, parking, traffic, and restaurant and bar hours, which may not have applied to the existing hotel property.

ii. Management and Operation

1. Typical Arrangements in Management Contract

- The amount of revenue the condo hotel owner and the hotel management company will receive. Usually the revenue is paid quarterly, and rental splits can range from as little as 18% to as much as 100% depending on other costs that are passed on to the owners. Typically, a 50-50 split after 10% is taken off the top for the franchise fee is common.
- Typical deductions before each of the parties receive their share, including money for a furniture and equipment reserve.
- Who pays for real estate taxes, insurance, capital improvements and debt service?

- Who pays for operating expenses such as housekeeping, front office, administrative and general, and marketing?
- A usage agreement which outlines the frequency and notice requirements when owners want to use their condo hotel units.

2. Condo Hotel Rental Program

One of the most crucial issues facing condo-hotels is the structure of the rental program and the sharing of rental proceeds among the hotel owner, the hotel operator, and the condominium purchaser. Essentially there are two basic sharing models. The first, based primarily upon the hotel owner's desire to sell real estate and be done with it, allocates almost all of the proceeds derived from the rental of the purchaser's unit to the purchaser, less the agent fee paid to the rental agent (usually the hotel operator). Under this model, the hotel owner does not participate in any of the proceeds from the rental of the sold units and, as a result, the rental program contributes little residual value to the hotel. The trade-off is to accelerate sales and maximize proceeds, since valuations and pricing will be higher based on presumably higher returns per unit.

In the other model, the hotel owner and unit owners split the rental proceeds. The hotel owner receives a portion of the rental proceeds less the hotel manager's fee, paid under the hotel management agreement, and the rental income flow enhances the hotel operations' residual value. In this scenario, the unit owner receives less rental income, and, therefore, the valuation and pricing of the

initial real estate sale will be somewhat less.¹⁰

3. Selecting the management company

The developer chooses the management company for the initial term, usually between 10 to 20 years, and usually that management agreement is tied in with his choice of franchise. After the initial term, the development is turned over to the condo hotel association which consists of the individual condo hotel unit owners. The owners vote on whether to keep the existing management firm and franchise or whether to make a change.

C. Pending Legal Issues

From a legal standpoint, federal and state securities law implications have a dominant influence on the structure and marketing of condo hotels. While a simple condominium sale usually does not involve the sale of a “security,” a security will be involved once a condominium sale includes almost any discussion of rental management services—through a hotel or otherwise—unless strict limitations are faithfully observed.

Securities Laws, particularly concerning liability if a development is deemed to have been sold as a security (and not properly registered), remain the primary legal concern.

For many developers and hotel companies, deciding whether or not the condo hotel should be offered as a federal security or not involves new

¹⁰₁₈“Condo Hotels: The Next Phase”, ULI, 2005

issues and weighing factors that are hard to measure. Under the heading of “security”, a condo hotel unit may be offered either (a) pursuant to the “private placement” exemption from registration under the Security Act of 1933, or in fact, (b) as a fully filed and registered security.

At first look, in concept, a security offering by private placement to accredited investors is attractive from the vantage point that it allows the sponsor to make generally places the offering on an investment standpoint rather than on a personal use and enjoyment.

On the other hand, projections, even those of third-party experts, tend toward optimism. When projections are not met, problems arise in the form of lawsuits and liability against sponsor, sales agents and related professionals including the maker of the estimates.

There may be little advantage to an SEC registration compared to a private placement because the main advantage of registration over private placement would be that the offering could be made to the “general public” without regard to minimum income/net worth standards. However, where a single unit in a condo hotel will be priced probably in the high six to low seven figures, very few who are not accredited investors would be qualified at such prices.¹¹

Most developers seek to avoid registration due to the time required, restrictions on advertising, broker requirements, and the use of deposits.¹² In order to avoid coming under the scrutiny of any federal or state securities

¹¹ Robert M. Chasnow, “Condo hotels: New trend of flash in the pan?”, 2005

¹² “Hospitality Industry Top 10 Thoughts for 2006”, Ernst & Young, 2006

agencies, developers refrain from providing information such as rental revenue expectations and return on investments for prospective buyers. Instead, the developer's emphasis in the condo hotel's marketing materials and sales presentations is always on the real estate itself.

This deprives condominium investors of a great deal of relevant and helpful information for evaluating their purchase. It also tempts aggressive salespeople to furnish the prohibited information on the side, which upon discovery could turn the whole scheme into an illegal offering of a security with attendant civil and criminal penalties, not to mention rescission rights for unit purchasers, which could run for many years.

Followings are the guidelines directly addressed by the SEC concerning the possible applicability of the securities laws to the offer and sale of condominium units 1973.

- Do not offer a rental arrangement that provides for the pooling of rental revenues
- Do not place significant restrictions on the purchaser's use of the condominium unit
- Do not emphasize the economic benefits of a rental agreement or similar collateral agreement¹³

There was a wave of buying in the 1970's when developers sold units more like investments, often structuring them as partnerships and registering them with the U.S. Securities & Exchange Commission. Some of them came complete with an accountant's table and revenue and profit projections, but disappointing investor returns, lawsuits and the Tax Reform Act of 1986

largely snuffed the market.

D. Development Status and Cases¹⁴

IN 2006, 32 projects with 4,831 condo hotel units are forecasted to open while 27 projects/5,025 units will open in 2007. The current Construction in the pipeline contains a total of 105 projects with 29,042 condo units, averaging a very high 276 units per projects. 44 condo hotel projects are currently under construction, 41 are scheduled to start in the next 12 months, and 20 are in early planning, 75% of all projects are ground-up new construction, while 25% of the projects will convert existing guestrooms in open and operating hotels to condo units. 45% of all pipeline projects are in Oceanside locations, while 10% are near the parks, and another 9% are at casino destinations. Florida has the greatest development activity, with 46% of all pipeline projects. Miami, Fort Lauderdale, West Palm Beach and Orlando are the popular locations. Condo hotels are a significant factor in the lodging industry's growth because without these products that draw such individual investor participation, large upscale hotel projects could not otherwise be conventionally financed and built so early in the industry's economic recovery.¹⁵

Condo Hotels in Non-U.S. Markets

Condo hotels are not solely an American phenomenon. The condo hotel has

¹³ Bart Bartholdt, "The condo hotel: When might the securities laws apply?", 2005

¹⁴ Partially from The BusinessWeek Website, www.businessweek.com and CondoHotelCenter.com

¹⁵ Lodging Econometrics, "LE '06-'07 Development Forecast for Timeshares, Condo Hotels and Hotels with Residences", December 14, 2005

been around for years in Latin America, and is now found throughout the Caribbean Islands, Canada and in parts of Europe.

Some projects in Dubai in the Middle East have had tremendous success and some of them have better than anything offered in the U.S., suggesting such rate of returns as 8% guaranteed and the right to assign the contracts at any time.

These are not features that are typically found in U.S. condo hotels, as guaranteed returns would violate U.S. Securities and Exchange rules that tell developers that they can sell the "real estate and the lifestyle," but they may not sell the investment aspects of a condo hotel.

Europe has been relatively slow to adopt the condo hotel concept, but the market is expected to be confident in the coming years.

i. W Las Vegas Hotel, Casino & Residences

The W Las Vegas will be a \$1.7 billion development that includes a mix of hotel and condo hotel units. It will be located on the corner of Harmon and Koval Streets in what's becoming known as the Harmon Corridor, less than a half mile east of The Strip.

The W Las Vegas will feature characteristic architecture, multiple restaurants, exhilarating nightlife and a destination spa. It will be the W brand's first casino and is destined to become its flagship property.



Highlights of the W Las Vegas include:

- 2,000 rooms approximately 500 of which will be condo hotels
- 7,400 m² casino
- 4,645 m² Bliss® Spa & gym
- 10 or more destination dining and & nightlife outlets
- 9,290 m² of world-class retail
- 27,870 m² conference center & meeting space

A four-star resort, it will be a joint venture between Edge Resorts and Starwood. Starwood owns the W brand as well as the Sheraton, Westin and St. Regis hotel chains. Starwood will manage the hotel.

Construction on the W Las Vegas is expected to begin in June 2007 and to be completed by early 2009.

46 m² studios and also 70 m² and 93 m² one-bedroom condo hotel units range in price from \$650,000 to \$1,300,000. There will also be a small selection of poolside bungalows and penthouses.

ii. Trump International Hotel & Tower(Chicago, IL)

The Trump International Hotel & Tower will be a first-class, mixed-use building with a condo hotel component located in the center of downtown Chicago's business district.

Occupying the site of the former headquarters of the Chicago Sun-Times, one of the city's two major newspapers, it has a unique asymmetric shape, giving the building a unique appearance from each angle.

The building faces North Wabash Avenue looking south and the Chicago River looking west. Just minutes from the Loop and the Magnificent Mile, Chicago's finest shopping, restaurants and cultural attractions are all at the Trump International's doorstep.



The development will include:

- 472 super-luxury condominiums from studios to three-bedrooms up

to seven-bedroom penthouses

- 286 five-star condo hotel units consisting of one- and two-bedroom suites
- 5,570 m² health club and full-service spa
- Heated indoor swimming pool
- Elegant fine dining on the 16th floor, offering views of the Chicago River
- 8,400 m² of exclusive boutique shopping
- 1,860 m² conference center and meeting rooms

They will offer all of the amenities and services expected of a five-star resort such as 24-hour concierge and room service.

Appointed with European designed furnishings, fully-equipped kitchens and state-of-the-art electronics, the condo hotel units will be highlighted by floor-to-ceiling windows, providing astounding views of Chicago's celebrated skyline.

Construction on the Trump International Hotel & Tower started in March 2005 and estimated completion is 2008. Prices for the condo hotel units start in the low \$800,000s.

iii. The Elysian(Chicago, IL)

The Elysian Development Group, Chicago, plans to build a 60-story luxury condo hotel and residence in Chicago containing 51 private condominium residences, 188 hotel suites, elegant dining, a private health club and luxurious spa and a grand salon.

The Elysian Hotel will be designed specifically to accommodate gracious city living, drawing on a philosophy of highly refined personal service and undivided individual attention as practiced by the intimate hotels of Europe. The Elysian will be used as an in-town second home, or for transient hotel business. The hotel and residence is slated to open in late 2007.



The hotel will be located at the southwest corner of Walton and Rush Streets, the Gold Coast of Chicago. It will be steps from great shopping at the exclusive Oak Street boutiques and the fashionable retailers along North Michigan Avenue as well as fine dining award-winning theater, museums and Chicago's famous lakefront.

The private residences, two to a floor, will range from 300 to over 930 m² and will start at \$2,000,000. The Elysian hotel suites are priced from \$460,000 to \$905,000 and range from 56 to 117 m².

The residences will feature a minimum of three bedrooms and 3½ baths, a professional kitchen open to the family room, a spacious living room, formal dining, library, two private terraces and a butler's pantry.

Private residence owners will enjoy the extensive amenities of the hotel, including a multi-lingual staff, concierge and business services, personal laundry service and around-the-clock in-residence dining.

Residences will also receive complimentary memberships to the Elysian Spa and Health Club, which will offer the full range of spa treatments, a swimming pool, personal trainers, and cardio and fitness equipment.

The Elysian Suites will range from 56 to 117 m² and will be appointed and fully furnished with rich woods, fine upholsteries and linens, as well as fireplaces, French windows, plasma televisions, urban kitchens, terraces and lavish stone baths.

Owners of the luxurious one-bedroom suites may enjoy them exclusively or place them in the hotel rental program. Owners will have exclusive use of a handsomely detailed personal armoire to store clothing and other special items until their next visit.

Elysian Development Group, LLC is a consortium of preeminent companies and individuals with extensive real estate experience in residential, retail, office, hotel, spa and mixed-use properties.

iv. Fontainebleau III Ocean Club(Miami Beach, FL)

The Fontainebleau III Ocean Club will be the third Fontainebleau property, all located next to each other in the middle of Miami Beach. Together they will occupy over 1,200 feet of beautiful, oceanfront land. No other hotel even comes close to having that much ocean frontage. And unlike any other condo hotel on the market, the Fontainebleau Hilton, a 900-unit hotel, has a 50-year operating history on which to base any revenue-generating projections for buyers of Fontainebleau III Ocean Club condo hotel units.

Fontainebleau II is a 36-story, 462-unit condo hotel that sold out about 10 months before delivery was even scheduled to begin. Because many buyers were left out on the doorstep, Fontainebleau III is likely to sell out even more quickly.



Fontainebleau III Ocean Club is intended to be a five-star condo hotel with a completion date of late 2006. It will be 18-stories tall with 286 condo hotel units, offering outstanding views of the Atlantic Ocean, Miami Beach and the Fontainebleau Hilton grounds. Fontainebleau III Ocean Club will be built on the south end of the Fontainebleau property, adjacent to Fontainebleau II.

Amenities:

- A private owners' lounge
- Pool
- Indoor/outdoor children's facility
- Water park featuring a 260-foot twisting water slide & more
- 24-hour security Valet parking
- The famous La Ronde Room
- Concierge
- Housekeeping services

Unlike most condo hotels, there will be no living restrictions at Fontainebleau III. Condo hotel unit owners can live there year round, if they desire. The developers are Stephen Muss of the Fontainebleau and Turnberry Associates, a very well-respected South Florida development firm.

Fontainebleau III Ocean Club is located close to the Miami Beach Convention Center (great for keeping those hotel rooms filled), trendy South Beach, the shops of Lincoln Road, the Bal Harbour shops, as well as various malls, and is just 20 minutes from downtown Miami and 15 minutes from Miami International Airport.

Pre-construction prices for units at Fontainebleau III range from \$450,000 to over \$1.0 million. The furnished studio and one-bedroom suites range from 50 m² to 108 m² plus terraces. There will be a few two-bedroom suites offered by combining an existing studio with a one-bedroom unit.

Hilton will manage all three Fontainebleau properties. Hilton Hotels Corporation includes Hilton, Conrad, Doubletree, Embassy Suites Hotels, Hampton Inn, Hampton Inn & Suites, Hilton Garden Inn, Hilton Grand Vacations Company, and Homewood Suites by Hilton.

v. The Trump International Hotel at in Manhattan

There are 167 hotel rooms and suites in the Trump International Hotel and all of them are condos. The owners recently had to pay for a \$12 million upgrade. For a one-bedroom suite facing Broadway, that worked out to about \$35,000.



In 2000, a very profitable year for the hotel industry, owners of a one-bedroom suite without a mortgage had a net gain of about \$35,000 from rentals; in 2020, their income dropped to about \$10,000. As for appreciation, a 64 m² one-bedroom suite was sold for \$585,000 in 2004 from \$385,000 in 1996. Owners of the Trump Hotel have a living restriction because the project received a 12-year tax abatement causing less appreciation than the residential tower.¹⁶

vi. St. Regis Resort & Residences in Bal Harbour, FL

St. Regis Resort & Residences will be a 26-story, three-tower complex constructed in Bal Harbour, Florida, just north of Miami Beach. Currently on the site is the Sheraton Bal Harbour. Plans are to close the hotel in June 2006, raze the building, and begin construction on the new St. Regis by the end of 2007.



All of the condo hotel units in the St. Regis will offer excellent north and south oceanfront views. While some of the architectural decisions are still being made, as of now, all the units will be studios of 72 to 78 m², far bigger than average studio. There are also a limited number of 120 to 138 m² hotel suites. The St. Regis has an intended star rating of 5-stars.

The St. Regis Resort & Residences will be owned and managed by Starwood, and will be run as a Starwood Luxury Collection property. Only about 10% of the hotels run by Starwood worldwide receive this esteemed classification.

¹⁶ Terry Prinston, "A room of your own", The New York Times, October 27, 2004

This condo hotel will offer luxurious amenities, including the St. Regis signature butler service, renowned concierge service, world-class Remede spa and a fine dining restaurant.

St. Regis Resort & Residences will be located right on the Atlantic Ocean. Across the street from its location are the world-famous and highly exclusive Bal Harbour Shops, which has 100 flagship stores including Chanel, Louis Vuitton, Saks Fifth Avenue, and Neiman Marcus.

vii. The MGM Grand Residences in Las Vegas, NV

The MGM Grand Residences will consist of three identical condo hotel towers built adjacent to the world-renowned MGM Grand Hotel and Casino on the Las Vegas Strip. They will be four-star luxury properties.

Each of the 38-story towers will have 576 condo hotel units. Tower A is completely sold out; all of its units were reserved in an eight-week period.

Construction on Tower A began in September 2004 and will be complete in mid-2006. Tower B is also sold out. Construction began in April 2005 and will be complete in early 2007.



Available now at pre-construction pricing is The MGM Grand Residences, Tower C to be built in mid 2007. Choose from studio, one- and two-bedroom units, priced from \$640,000 to \$2.3 million

Residents of the MGM Grand Residences will enjoy numerous amenities, including a fitness center, concierge, fully staffed lobby, swimming pool and 24-hour security.

The individual condo hotel suites at the MGM Grand Residences will be fully furnished with a wide array of custom designer amenities such as crown moldings, raised panel wood doors, granite countertops and imported Italian kitchen cabinetry by Snaidero.

The MGM Grand Residences condo hotel units will also have Sub-Zero refrigerators, Meile appliances, ultra-luxurious bathrooms with Jacuzzi tubs, plush wall-to-wall bedroom carpeting, ultra-thin LCD flat screen HDTVs, high-speed voice/data connectivity and private owners' closets for added storage space.

Condo hotel owners at the MGM Grand Residences will have access to all the amenities at the MGM Grand Hotel, including its 15,886 m² casino, five outdoor pools, the Grand Spa with 30 treatment rooms and a fitness center, a variety of signature and casual restaurants, shopping outlets, and world-class entertainment.

The MGM Grand Residences will have a premier location just off the Strip in Las Vegas, offering convenient airport access and its own station for the new Las Vegas Strip monorail.

The developer for the MGM Grand Residences is Turnberry Associates which was founded in 1967 by Donald Soffer and is now under the leadership of his son, Jeffrey Soffer. The company has to its credit the development of more than \$5 billion in commercial and residential property including the Fontainebleau II and Fontainebleau III Ocean Club, two premier condo hotels in Miami Beach, FL.

viii. THE WINDSOR RESIDENCE APARTMENTS in Dubai, UAE

The Windsor Residence Apartments will be a five-star condo hotel located in a section of Dubailand known as the City of Arabia. Dubailand will be a city of theme parks and visual splendors within the country of Dubai, one of the seven United Arab Emirates.



It will encompass approximately 90 square miles and will contain 45 mega-projects including several immense theme parks, and over 200 tourism, leisure and entertainment sub-projects. When complete, Dubailand will be nearly three times the size of all of Walt Disney World Resort in Orlando.

The City of Arabia, the area of Dubailand in which Windsor will be located, will be a 1,858,000 m² development that serves as the main residential and retail center. It will contain luxury apartments, businesses, schools, shops, restaurants and more.

The Windsor Residence Apartments will be Dubai's first condo hotel (despite the word "apartments" in its name). It will consist of 30 stories containing 200 condo hotel units. It will be managed by a major international hotel chain.

On-site amenities will be of five-star caliber and will include restaurants, lounge, boutiques, health club, spa, swimming pool, business center, meeting space and tennis courts.

Construction on the Windsor began in October 2005 and is expected to be complete by the end of 2007.

E. The Key Success Factors and Outlook

i. The Key Success Factors¹⁷

- Good Location

As always with any real estate deal, location is of the utmost importance. However, with a condo-hotel project it is doubly important because you need to be in a location that is attractive separately to a hotel user and a condo buyer. If a poor site is chosen, or a site that isn't mutually beneficial for the two real estate products, then you'll find that one (or both) of the product type will fail. The hotel product will fail if there are no demand drivers for this location or the condo product will fail due to its unappealing condo location.

It also needs to be in an area that as stand-alone properties, comparable condo projects and comparable hotel projects have been individually successful.

- Attractive Amenities

Attractive amenities are the "insurance" required to maximize the chance of the project being a success. The types of desired amenities to help sell the units include:

- Concierge service
- Valet parking
- Housekeeping
- Room service
- 1st class outsourced restaurant/bar

- Swimming pool
- Health club
- Spa facilities
- A great amenity package helps ensure that the units are rented for the highest room rate and the highest occupancy rate possible.

- Respected Developer

Obviously, someone has to put this project together and make it all happen. There are lots of moving parts in a project of this scale and a respected and successful developer is required to put his reputation on the line and take the financial risks required to properly complete the project.

- Hotel Operators

Hotel operators are obviously a large success factor in a condo hotel project. Since many buyers of the condo hotel unit will be from out of town, they need the reassurance of knowing that their property will be left in good hands, preferably at a hotel flag that they would normally frequent in their own travels. Their strong internal reservation system helps to maximize the room revenue for the periods when the units are placed in the rental pool.

ii. The Outlook

Some major hotel operators still harbor doubt about the concept, fearing that the money pouring in from individual investors is causing projects to be launched that would not be built otherwise. Of all things, a

¹⁷ Gibbs, Brian Charles, "Condo-hotels: in New Orleans?", Columbia University, 2003

development project should be viable as a hotel itself. Individual investors should be cautious that because of the current wave of condo hotel conversions and new construction is so recent, there is no established track record regarding the long-term appreciation in real estate value of the units at resale. Should the anticipated appreciation not materialize, the concept could very well start falling out of favor.

As condo hotels are especially booming in certain resort areas such as Miami, Ft. Lauderdale and Las Vegas, anti-growth sentiment is growing. In fact there have been claims made by concerned citizens that the cities have given too many waivers on height, setbacks and parking for development projects in many South Florida cities.¹⁸ In Hollywood, the officials are currently reviewing applications for several hotel-condominium projects totaling 2,500 units. With the exception of one traditional hotel application, all the hotel-related applications before Hollywood officials are for hotel condominiums. Hollywood has just adopted new rules for hotel condominiums that limit owner occupancy to 90 days a year, and require hotel amenities, including a lobby and maid service.¹⁹

Quantifiable forecasts for hybrid hospitality projects are simply not as clear, since many seem to be based on concept and aspiration versus historical data. Research indicates that there is consumer desire to own a second home as a real estate investment with the combination of consistent yield, appreciation and value-added opportunities. The

¹⁸ Daily Business Review, March 19, 2004

¹⁹ "It's a hotel. It's a condo. No, it's both!", USA Today, September 27, 2005

prescription may be a condominium, which can yield financial returns as part of a hotel's inventory, or a fractional ownership location, which provides a vacation home option without the upkeep headaches.²⁰

Condo hotels are expected to spread into big cities from resort areas. In Chicago demands in condo hotels are increasing as people who live in suburbs tend to enjoy city life during the weekend or holidays. There are many more luxury condo hotels under construction or plan in major cities such as New York, Chicago, Boston and San Francisco.²¹

There is little doubt that condo hotels are an intriguing approach to the development of lodging properties, and as its use becomes more common in the market, levels of understanding by both the lodging industry and the condo buying arena are projected to increase.²²

iii. The Unknown

From both an investor and hotelier perspective, the long-term evolution of the condo hotel product will be interesting to watch. Consider the following:

- The hotel operator in a condo hotel is beholden not to one or several owners, but potentially to hundreds of owners of the condominium units, each of whom might scrutinize and argue about operating budgets as they relate to maintenance fees and assessments.

²⁰ "Despite lack of long-term data, hotel developers favor hybrid projects", RSBA & Associate, 2005

²¹ "Condo hotels move beyond resort town", The New York Times, April 2, 2004

- As in any condominium, the unit owners ultimately have the voting power to control the building budget. What would happen should the unit owners provide insufficient capital to maintain the building at operator or brand standards and the flag is removed? Such an event could have a serious impact on the operating levels of the hotel as well as on returns to owners.

- In the typical condo hotel, the developer sells all the units but maintains ownership of the common areas, restaurants, etc. Arguments related to allocation of expenses between the owners of the units and the owners of the common areas have already made headlines at several condo hotels, with the promise of more to come.

- Because of the current wave of condo hotel conversions and new construction is so recent, there is no established track record regarding the long-term appreciation in real estate value of the units at resale. Should the anticipated appreciation not materialize, the concept could very well start falling out of favor.

The framework and operating scenario by which a condo hotel functions is a very complex and rapidly evolving one which taxes the skills of even the brightest and most experienced legal minds. From the developer's perspective, the condo hotel structure provides a creative way of getting a hotel development done which might not be economically justified or feasible otherwise.

The conflicting needs and interests of all parties must be reconciled through a complex layering of CC&Rs, HOA documents, rental management program agreements, hotel management agreements, operating business plans, and the like. Achieving a structure with the right balance of profitability potential and long-term viability is critical for a win-win project. If done properly—with the right expectations of all involved, and also the right structure, sponsorship, and integration of the hotel and condominium components—there could be a bright and long-term place in the mixed-use spectrum for condo hotels.

III. Introduction of the Condo Hotel Concept to Korea

A. Introducing the Condo Hotel Concept to Korea

i. Overall Market Situation²³

Tourist hotels, family hotels, the Korean traditional hotel and the floating tourist hotel, and recreation condominiums are presently classified as tourist lodging business in Korea. First, tourist hotels are deluxe first class, deluxe second class, first class, second class or third class, and there are newly registered hotels with classes. There are 550 businesses with a total of about 59,000 guest rooms as of the end of December 2004. Among them, there are 44 deluxe first class hotels with about 18,100 guest rooms. Second class hotel businesses number 133 but only 6,923 guest rooms. Most tourist hotels are in Seoul, Busan and Jeju.

As a result of economic development and implementation of the 5-day work week, increasing numbers of family tourists recently stay in family hotels. Kitchen, sports and recreation facilities are mandatory in family hotels by the relevant law. In Korea there are 17 family hotels with about 2,600 guest rooms as of the end of 2004. Gangwon Province has the most family hotels, 6 totaling 463 guest rooms, while those in Jeollabuk-do have the most guest rooms 1,430 in 3 hotels.

Korea's unique "traditional hotel" is a luxury hotel with lodging in the

²³ "Year Book on the Tourism Trend in Korea", The Ministry of Culture and Tourism, 2005

form of traditional Jeju-style Korean thatched roof houses at the Chungmun Sea Village with 28 guest rooms immediately adjacent to the sea.

The floating tourist hotel is a moored floating structure, or a ship, with full tourist facilities. One business in Haeundae, Busan, has been operating such a hotel with 53 guest rooms since 2000.

Existing old traditional residences and temples are planned to be used and expanded, improving them as distinctive tourist lodging facilities for globalization of Korea's excellent traditional heritage, in preparation for the expanded demand due to the new 5-day work week and the era of 10 million foreign tourists. Andong Hwahoe Village, Seongeup Folk Village, Weolseong Yangdong Village, Goseong Wanggog Village, Asan Oeam Village, and Nakan Eupseong Village have been designated as traditional folk villages, and there are 37 traditional heritage villages. In addition, "old traditional residences" refer to traditional structures more than 50 years old, regional cultural assets and private houses with historical significance and cultural value; 662 houses have been so designated in Korea as of 2004.

According to the forecast from the Ministry of Culture and Tourism, Korea is expected to suffer from the shortage of hotel rooms in the near future. Whereas tourists from overseas are increasing each year, the supply of hotel room can not meet the demand due to the high construction cost and scarcity of potential sites. In fact, during the last 10 years foreign tourists have increased 66% but the number of hotel rooms

shows an increase of only 21%. The Ministry of Culture and Tourism forecasts the deficiency of 55,000 hotel rooms in 2008.²⁴ Korean government is pushing forward various policies to meet the demand including financial aids, tax favors, administrative support, etc.

The hotel industry in Korea is highly concentrated in Seoul, Busan and Jeju. These three regions account for more than half of the total hotel rooms in Korea²⁵ and the hotels above Deluxe Level in those regions are mainly accommodating foreign visitors for business and travel.

Condominiums which are scattered across the country are playing a major role to accommodate domestic travelers.²⁶ Even though the condominiums are run by membership system, it is not easy for the members to reserve rooms during weekends, holidays, and vacation season because most condominium companies are accepting more than appropriate members and sometimes allocate some portions to on/off-line travel agencies

With more income and spare time backed by 5-day work week system, the middle class people are dreaming of owning their own place to spend their spare time without crowdedness. But expensive housing price and maintenance cost are major hindrance to possessing their own places.

²⁴ "18 Major Policies to Promote Korean Tourism", The Ministry of Culture and Tourism, 2004

²⁵ "The Year Book on the Tourism Trend in Korea", The Ministry of Culture and Tourism, 2005

²⁶ "Surveys on the behavior of domestic travelers", Korea Tourism Organization, 2005

Table 1. Status of Tourist Lodging Business²⁷

Category	Deluxe 1st Class		Deluxe 2nd Class		1st Class		2nd Class		3rd Class		Class Pending*		Total	
	No	Rm	No	Rm	No	Rm	No	Rm	No	Rm	No	Rm	No	Rm
Seoul	16	8929	20	4996	33	3861	27	1714	10	570	6	498	112	20568
Busan	5	2311	4	850	14	1222	15	767	15	634	6	1355	59	7139
Daegu	1	342	7	551	15	881	5	247	-	-	1	32	29	2053
Incheon	2	700	4	655	5	289	9	373	6	238	3	173	29	2428
Gwangju	-	-	3	259	8	501	5	223	2	68	2	103	20	1154
Daejeon	-	-	3	585	7	465	11	468	2	62	3	154	26	1734
Ulsan	2	495	-	-	-	-	2	146	1	38	1	75	6	754
Gyeonggi	-	-	4	480	22	1456	16	839	7	284	9	651	58	3710
Gangwon	1	477	9	1386	10	668	3	152	2	94	4	209	29	2986
Chungbuk	-	-	1	180	18	1303	2	73	3	97	-	-	24	1653
Chungnam	-	-	2	270	3	324	5	217	2	75	-	-	12	886
Jeonbuk	1	118	2	277	5	383	4	203	0	0	-	-	12	981
Jeonnam	-	-	1	58	9	599	6	263	7	267	1	50	24	1237
Gyeongbuk	5	1698	3	521	15	910	12	690	10	458	3	127	48	4404
Gyeongnam	-	-	3	411	13	1115	7	365	2	67	0	0	25	1958
Jeju	11	3193	4	575	18	1598	5	284	5	251	1	303	44	6204
Total	44	18263	70	12054	195	15575	134	7024	74	3203	40	3730	557	59849

* Class pending refers to newly registered hotels, including those hotels with a review on class not yet held at the said point in time.

²⁷ Korea Hotel Association, www.hotelskorea.go.kr. 2005

Table 2. Rate of Increase of Hotel and Rooms

Year	Category	Number of Hotels		Number of Rooms	
		Number	Rate(%)	Number	Rate(%)
1978		130	12.1	15,327	31.6
1979		141	8.5	18,457	20.4
1980		123	-12.8	18,547	0.5
1981		129	4.9	19,702	6.2
1982		144	11.6	21,459	8.9
1983		154	6.9	22,800	6.2
1984		157	1.9	23,013	0.9
1985		165	5.1	23,771	3.3
1986		172	4.2	24,560	3.3
1987		221	28.4	27,963	13.8
1988		276	24.8	33,869	21.1
1989		367	32.9	39,091	15.4
1990		428	16.6	42,817	9.5
1991		441	3.0	44,029	2.8
1992		445	0.9	44,551	0.1
1993		446	0.2	45,096	0.1
1994		449	0.7	44,884	-0.5
1995		450	0.2	45,469	1.3
1996		455	1.1	46,727	2.7
1997		446	2.0	46,894	0.4
1998		452	1.3	46,998	0.2
1999		457	1.1	47,536	1.1
2000		474	3.7	51,189	7.7
2001		488	3.0	52,069	1.7
2002		511	4.7	54,086	3.9
2003		534	4.5	56,196	3.9
2004		550	3.0	59,135	5.2

ii. Similar Cases in Korea

Recently, unusual hotel projects have been sprung up in Jeju, Busan and Gangwon. In some respect, those projects have similarities to the condo hotel concept in the U.S. as they sell each hotel room to individual investor and bestow certain period of time to use the hotel room and they put the room in the rental program when not in use. Also the locations are mostly near the resort areas or big cities.

But they are different from the condo hotel concept in aspect that they suggest and even guarantee a certain rate of return to individual investors. As previously reviewed in this study, SEC enforce the developer to refrain from mentioning profitability of the project toward individual investors and the developers actually sell the product mainly as life style rather than investment object. Currently no regulations or guidelines on selling hotel rooms exist in Korea and developers promote their projects by guaranteeing specific returns on investment usually from 8% to 10% endorsed by financial institutions.

Also there are people who invest in those hotel units to evade the heavy Real Estate Transfer Tax which has been strategically legislated to stabilize real estate price by the government.²⁸

So far, this style of business is quite similar to the earlier condo hotel projects of the U.S. in 1960's and 1970's.

²⁸ "Buying a house without fear of Real Estate Transfer Tax", Chosun Ilbo, March 28, 2005

Table 3. “Quasi-condo hotel” projects in Korea.²⁹

	A Hotel	B Hotel	C Hotel
Location	Busan	Jeju	Changwon
Size of land	4,788 m ²	4,010 m ²	N/A
Size of hotel rooms	63 ~ 165 m ²	50 ~ 100 m ²	60 m ²
Number of rooms	543	386	41
Owner's usage of hotel room	60 days per year	30 days per year	7 days per year
Guaranteed rate of return	8% for 3 years and additional incomes available upon the rental performance	9.1% for 5 years and additional incomes available upon the rental performance	8% for 2 years
Operator	Swissotel	Watertree AMC	N/A

²⁹ “RDN Newsletter Special III”, Real Estate Development Network, 2005

iii. Approaches to Introducing Condo Hotels

When applying the condo hotel concept to Korea, we can approach in two aspects. One is to meet the demand for more hotel supply and the other is to enhance the people's welfare to enjoy their leisure and travel.

Korea is suffering from the deficiency of hotel rooms to accommodate foreign and domestic travelers. Even though the demands are high, there exists not enough room to enhance hotel facilities because of the high cost. The Korean government is granting various incentives to facilitate more hotels but those incentives are not enough to offset the burden. If the government can strategically utilize the condo hotel concept, the hotel developers' burden should be significantly reduced by the pre-sold portion of hotel units. All the government has to do is to prepare institutional device and guideline so that condo hotels can be properly settled down. The details of regulation which the government needs to prepare will be reviewed in the later part of this thesis.

Also as previously mentioned, more and more people wish to enjoy their leisure time comfortably and pleasantly whenever they want. That trend will be combined with the rapid retirement syndrome which will be begun in the near future as Korea is one of the fastest aging countries where the people are aging so fast. Cities similar to Miami, Ft. Lauderdale and Las Vegas in the U.S. preferred by the retired are expected to spring up in Korea as well.

iv. Fostering Condo Hotels in Tourism & Leisure City (TLC)³⁰

Korean government is now pushing forward to create “The Tourism & Leisure City” in several places in Korea. Even though the policy was created as one of the propeller to achieve the balanced development which is the major campaign of this administration, it may provide places where people can enjoy their spare time as well as develop the tourism industry.

“The Tourism & Leisure City” ought to reflect the trend of the general public’s need to become more like the cities mentioned above. In this regard, a properly designed and developed condo hotel concept will play an important role to achieve the government’s goal.

Background

The Tourism & Leisure City is a new form of urban development in Korea. The Ministry of Culture and Tourism has commissioned the development of the Tourism & Leisure Cities in accordance with the “Special Act on the Development of Corporate Cities” that was enacted at the end of last year. The philosophy behind the “Corporate City” is the building of a dynamic and livable city that is directed by creative business from its inception. In other words, a Tourism & Leisure City is a business-led urban development conceived with the goal of developing an urban area with industrial and business centers, and

consisting of core functional areas in industry, research, tourism and residential areas dedicated to housing, education, health care and cultural pursuits.

Realizing the necessity to boost local investment and to bridge the gap between the demand and supply in tourism industry, the Korean government devised a new policy that would encourage the construction of a mega-scale tourism infrastructure and unveiled an appropriate vehicle to satisfy both the needs of investors and the market: the Tourism & Leisure City.

History

In October 2003, the Federation of Korean Industries (FKI) proposed that the government initiate corporate city development in order to boost business investment and create new jobs. The FKI also asked the government to establish a special law to implement development. In order to achieve balanced regional economics development, the government accepted the FKI proposal and prepared the enactment of the “Special Act on the Development of Corporate City” to promote private investment and the local economy. A draft act was introduced in June 2004, and consultations with relevant agencies, experts and community organizations were conducted.

The draft act was passed by the National Assembly on Dec. 9 and went into effect Dec. 31. In order to promote the efficient development of Tourism & Leisure Cities, the Planning and Development Commission for the Tourism & Leisure City was established within the Ministry of

³⁰ Lim Byung-Soo, “Driving Force for Balanced Development”, Ministry of Culture and Tourism, 2005 51

Culture and Tourism with four constituent teams.

Requirements for the eligibility

Since the Corporate City System is based on the initiatives of individual business and a wide degree of latitude given by the government, some requirements have been put in place.

First, candidate areas designed as “Least Development Regions” according to the “Special Act on Balanced Regional Economics Development” will be given priority in the selection process, while restrictions will be placed on already developed regions, such as the Seoul Metropolitan Area and other metropolitan areas in regard to the development of Tourism & Leisure Cities.

Second, a Tourism & Leisure City designation will be confined to areas where development is both environmentally sustainable and economically feasible. Third, since active support of local governments and smooth community relations are critical for success, a proposing company must come in partnership with the local government in question in order to bring a project to realization in a satisfactory manner.

Three Pilot Projects

The Ministry of Culture and Tourism selected three pilot projects under the Tourism & Leisure City program: Taean, Muju and Yeongam/Haenam Tourism & Leisure City.

- Taean Tourism & Leisure City will be located in Cheonsuman Bay in Chungcheongnam-do Province. Taean TLC has been proposed by Hyundai Engineering & Construction Co. and the Taean County administration. The plan includes theme parks, an eco-park, golf courses, schools, university, and residential complexes. The development area is estimated to be 15.6 million square meters and the cost of the project, \$2 billion.

- The southwest Tourism & Leisure City in the Yeongam and Haenam area will be located in Jeollanam-do Province. Fifteen foreign and domestic companies, together with the governor of Jeollanam-do Province have proposed Southwest TLC. The plan includes theme parks, a marina, the Formula One auto race stadium, hotels, casinos, golf courses, schools and residential complexes. The development area is estimated to be 3.3 million square meters and the cost of the project, \$10.5 billion

- The Muju Tourism & Leisure City will be located in Doksan-ni and its vicinities, including Anseong-myeon, Muju-gun, Jeollanam-do Province. The Muju TLC was proposed by Taihan Electric Wire Co. and the Muju County administration. The plan includes a water park, golf courses, time-share condominiums, a research complex, schools and residential complexes. Also included are “well-being” amenities, such as fitness center, healthcare center and spa. The development area is estimated to

be 8.1 million square meters and the cost of the project, \$1.8 billion.

B. Lesson from the experience of the U.S.

i. Between Lifestyle and Investment

As we witnessed in the experience of the U.S. in 1970's and 1980's, suggesting the rate of return and treating the condo hotel projects like profitable investment will make it easier to attract the individual investors. But if the results turn out to be disappointing, then nobody will be interested in the concept and it will be abandoned for a long period of time.

Those developers who guarantee certain returns reassure dubious investors by presenting certifications of banks or insurance companies.³¹ Although financial institutions guarantee the returns for the developers, usually the guarantee periods last only a few years. They say after that period they can make a contract again, but those financial institutions will not guarantee it anymore if the business slackens. Then upheaval and lawsuits will obviously take place.

It can not be denied that investment opportunities such as income from participating in a rental program and great appreciations in most of the condo hotel projects were the reasons for being so popular in the U.S.,

but the priority is not to buy it as an investment but a lifestyle. That is what they've learned from the precedent experience.

ii. Enactment of Regulation

It is not right to blame solely the investors who emphasize on the profitability in selling the development projects. They are just seeing through what people need and trying to make their projects as attractive as they can.

The problem is the deficiency of relevant laws or regulations to guide to right path as SEC in the U.S.

The condo hotel concept is so brand new that no law and regulation can be found in Korea. In fact, when one development company asked the Jeju Provincial Government for permission to sell their hotel unit to individuals, the local government could not find relevant laws and requested an authoritative interpretation to Ministry of Construction and Transportation, Ministry of Culture and Tourism, and Ministry of Welfare.

According to Korean law system, tourist hotels are regulated by The Tourism Promotion ACT, and ordinary hotels are regulated by The Construction ACT.

Condo hotels may be ruled either by TPA or CA but should be prescribed to maximize the advantages that will enhance travel

³¹ Joong Ang Ilbo, December 17, 2003

opportunity and minimize the abuse occurred by utilizing the concept as just for money making business.

When it comes to the legislation, the followings will be noteworthy for consideration.

- Prohibiting any suggestion or guarantee of returns

To prevent any future disturbance, it is prohibited to attract individual investors by suggesting and guaranteeing a certain rate of return. The condo hotel concept should be treated as owning a second home for relaxation. Incomes generated from the rental program and appreciation of the asset should be regarded as additional advantages that may not actually happen.

- Granting tax favors

The condo hotel concept is a quite useful tool to increase the supply of hotel rooms that are expected to be insufficient in the near future as the developers and lenders can mitigate the risk of financing the project with the preset components for sale.

Real estate tax exemption would help individual investors to consider owning condo hotels for their purposes.

- Fostering a resort city to fit the condo hotel concept

As we can see in the case of the U.S., it is important to foster certain areas as a cluster of necessary facilities. To utilize the condo hotel concept may be a good way of developing the resort cities. Apart from tax incentives to the individual owners, administrative support

from the government and financial support must be sought to facilitate participation of developers or lenders.

- Excluding condo hotels from the houses liable for taxation

According to the Korean real estate taxation, those who possess more than one house are subject to heavy taxation to prevent any speculative investment on real estates. As the concept of condo hotel lies between residence and hotel, there is room to construe having condo hotel rooms as an investment in real estate. Surely, there should be measures to prevent any attempt to speculate in condo hotel market especially in big cities but certain developments in rural resort area should be facilitated by excluding them from the liability for the heavy taxation.

If the condo hotel rooms come to be free from the tax liability, Lock-out units can be an attractive product for Korean consumers. Lock-out units are two or more individual units located next to each other and separated by a door. Each of the two units contains its own bathroom and kitchen area. The units can be rented together or separately. The primary benefit of lockout unit is that they can be used as several one-bed-room units or large units if combined altogether. It can maximize the rent revenue while giving more flexibility to use their units.³²

³² Condo Hotel Center Website, www.condohotelcenter.com, 2006

IV. Conclusion

Even though there is no denying that the condo hotel concept has many attractive features or benefits, the complexity and peculiarity of the concept make us to carefully approach the application in Korea.

First of all, regulations or guidelines governing the condo hotel concept should be legislated as soon as possible to make it clear whether the sale of hotel rooms is permitted or not. As previously reviewed, there are already several projects that sell hotel rooms to the individuals regardless of any legal basis and they even guarantee certain rate of return to attract individual investors. But due to the lack of legislation, the government authorities cannot take any measures to protect the individual investors.

Also we have to be careful of abusing the concept to mislead the general public. There are many individual investors in Korea looking for alternative investment opportunities as the interest rate is low and the Korean government is pressuring speculative real estate investment. So it would tempt the developers to promote condo hotels as a lucrative investment by guaranteeing certain amount of return on investment. In that case if the performance of condo hotels falls behind the expectation, the result would be disastrous as we saw what happened in the U.S back in 1980's. Individual investors should assume that the rental revenue may be nominal and will only defray the cost of ownership and maintenance.

The bottom line in developing condo hotel project is that what guarantees the success is to thoroughly examine the market and properly design the master plan. Condo hotel development projects are needed to make market and economic sense as a hotel itself before ever being considered as a condominium hotel. Subsequently, evaluating the economics of a condominium-hotel development beyond unit-pricing, such as structuring of association fees, rental program fees, and fair revenue and expenses allocations, remain key issues for this segment. As the condo hotel concept has so many potential “land mines” surrounding the condominium-hotel segment, seeking sound legal and advisory guidance and having adequate preparation, documentation, and disclosure are absolutely necessary in Korea as well.

The condo hotel concept can be a useful tool to cope with the current tourism trend in Korea providing second homes without costing high expenses. In this regard, this study suggests that the governments should involve in one way or another. Legislating adequate guidelines might be the most urgent necessity but more positive actions are required judging from that fact that the condo hotel can enhance the Korean people’s welfare and happiness. This study also suggest to utilize “The Tourism & Leisure City (TLC)” as a test bed to cultivate the concept of second home and new life style to correspond the recent trend in travel and leisure. The condo hotel units in TLCs should be exempted from the liability of taxation levied to who possess more than two houses. And the developers should be able to easily access the Tourism Promotion Fund in addition to administrative support from the central and local government.

As the condo hotel concept is very new and is treated as an alternative investment in Korea, the main interest of the owners would be limited only to securing the guaranteed returns rather than positively involving the operation and management. In the U.S., Home Owner Association (HOA) is playing important role by contracting rental management program agreements and hotel management agreements with developers or hotel operation companies. They try to maximize their utilization of the hotel unit while maintaining maximum rental incomes. They often fire operating companies when the performances don't meet their expectation. Until the concept is familiarized, certain format or guidelines should be prepared by relevant authorities to protect the home owners.

The condo hotel concept has just started to spread to worldwide from the U.S. and Korea also can not be an exception because the whole world is experiencing common financial, social and demographical phenomenon. The most important point in applying the concept is to wisely modify it in accordance with the actual circumstance of Korea.

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