

Fractional Home Conversion

A Summary Guide for Sellers¹

¹ This summary guide is based on the book: Vacation Home Fractional Conversion: A Complete Guide for Home Sellers, Builders and Real Estate Professionals (ISBN: 978-09816427-0-3). This ebook is meant as an introductory text. To get a \$10 credit from your purchase of this guide toward the full Vacation Home Fractional Conversion guide, see the last section of this ebook for a link and coupon code.

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P R E F A C E

LET'S TALK ABOUT YOU

Before we do anything else, let's talk about you. Let's talk about where you are right now. Let's talk about the time and money you've invested in your home and the returns you're getting.

As a home owner looking to sell, you invested time and money to purchase, maintain and upgrade your home, building a valuable asset. Faced with the need or desire to liquidate that asset, you realize that the market is soft, your asset has depreciated dramatically and there are few qualified buyers who are willing or able to commit to a sale. You are wrestling with a very difficult decision: if you needed the money your home was once worth, you won't get it. If you sell now, you'll never get the chance to recoup your loss.

CURRENT TRENDS

Current statistics taken from the National Association of Realtors tells us that the broad real estate market is in a general decline: sales have fallen nearly 21% over the past two years alone – and there is no relief in sight.

This means that, for all the reasons you might care to name, the old model isn't working the way it once did. It means that, like it or not, you have two choices: You can cut your losses or you can become an expert who profits from the new model and enjoys record growth and success.

A SURE SIGN OF MADNESS

Someone once said that a sure sign of madness was to keep doing the same thing and expect different results. If you've bought and sold houses in the past and you've enjoyed success, we congratulate you. If you're hanging onto those past successes in the hope that they will support you as today's market continues to erode, we need to talk.

THE SOLUTION IS CLEAR – THE ANSWER IS HERE

The fact is, the driving forces that contributed to your past successes have changed. Some analysts are saying they've changed for good. Whether or not that is true, you know that the industry is at a crossroads. If you want to survive and thrive in today's economy, you're going to have to apply niche market thinking and adopt a model that works in today's market. You're going to have to educate yourself and upgrade your skills.

FRACTIONAL CONVERSION – WHAT'S IT ALL ABOUT?

Question: In today's down market, how do you create a unique opportunity for prospective home buyers that enables them to buy in spite of their challenges and sets you apart from traditional sellers?"

Answer: The answer is fractional conversion – transforming the single ownership model to shared ownership, providing buyers and sellers alike with a new and better paradigm for vacation home ownership.

When people look at vacation home investment, the issue they wrestle with is not whether they deserve it, want it or need it. The question they have difficulty answering is: *Why pay full price for a place that sits vacant most of the year?*

If you, as a home seller, could offer your buyers a chance to limit their costs, pay for their usage and maintain deeded ownership and appreciation potential, wouldn't that be a more desirable scenario? Wouldn't that represent a better option to them – not just for economic reasons, but for status, comfort and peace of mind as well?

Fractional ownership is catching on. Each year, more and more buyers are finding that the economics of shared ownership are hard to resist. This growing trend is driving up the demand for fractionals in every corner of the world, even while the rest of the housing market cools.

FRACTIONAL CONVERSION – WHAT DOES IT MEAN TO YOU?

How you decide to capitalize on the coming trend in fractional ownership is up to you. What is essential to grasp at this time is that a solid education in this rapidly growing industry is key to your future success. Knowledge is power and it is this power that will allow you to create value for others. When you do this, your return on your investment is a thousand-fold higher than its cost you.

“There is no security on this earth, there is only opportunity.”
General Douglas MacArthur (1880 - 1964)

INTRODUCTION

For anyone eager to get into a growth market, fractional ownership of vacation homes is clearly the breaking wave. Research study group Ragatz Associates confirms that the current down market has had no impact on the fractional industry, which has enjoyed a greater than 50% increase from only three years ago, numbers that illustrate the universal appeal and resiliency of this industry, especially in a down market.

Our focus with this guide is to introduce you to the largely untapped market of individual, stand-alone fractional homes and the incredible opportunity they offer to anyone who recognizes that interest in these types of fractionals is going to increase exponentially.

Ragatz suggests that we are looking at the tip of the iceberg today. That with a current penetration rate sitting at just 1.5%, fully 75% of the market has yet to be tapped. 3 This statistic is HUGE. It means that the opportunity in this market represents TENS of BILLIONS in sales over the next decade as people warm to the concept of shared ownership. Even if sales stay relatively constant – at the current \$1.7 billion annually – the total comes to \$17 billion in new sales in the fractional ownership industry over the next ten years.

The questions you're asking right now are...

- 1. Who are these buyers?*
- 2. What's driving this growth in fractionals?*
- 3. How can someone capitalize on this trend?*

Let's take a look at the answers...

1. Who are these buyers?

The trend is being propelled by buyers (mainly baby boomers) who are looking for better ways to buy and own vacation real estate. The demand is growing thanks to the early adopters. As they start spreading the word, mainstream buyers will jump in. We've seen this with past trends driven by the Boomers as the generation matured. Think back to...

- Housing Starts
- Baby Food
- New Schools
- Mini Vans
- Fitness clothing and gyms
- Communications Technology

And most recently...

- Anti-aging Campaigns

At the turn of this century, the first wave of Boomers turned sixty and began thinking about their retirement years. A primary focus was to maximize their ability to support a luxury lifestyle in vacation destinations here at home and around the world.

The Boomers won't be running out of money any time soon. As the generation that raised them passes, an estimated multi-trillion dollar wealth transfer will keep the party going for the Boomers for the next three decades at least, as individuals in their forties, fifties and sixties continue to invest in lifestyle purchases: cars, clothing, dining, travel and vacation real estate.

2. What's driving this growth in fractionals?

According the National Association of Realtors (NAR), the average vacation

home buyer spends less than 2 months per year in vacation homes that cost, on average, \$300,000! Furthermore, fewer than one quarter of these owners rent out their vacation homes when they aren't using them.

As the huge Boomer population drives the trend, resort and vacation real estate is appreciating rapidly and will continue to do so, despite the current down turn in traditional markets. For many people just entering their retirement years, this means they are finding themselves priced out of their favorite vacation spots. Do they want to find ways to circumvent this dilemma? You bet they do!

This trend has appeal for Gen X, Gen Y and Echo Boomers as well. Thanks to today's technology, vacation living is not just for retired people any more. People can stay connected no matter where they reside, which means that they can travel to remote areas of the world and stay in touch with the office. What better way to run your business than from a getaway destination that you actually own?

3. How can someone capitalize on this trend?

Though the model was created by big developers with high-end resorts, it is equally workable for small developers, individual home sellers and real estate agents looking for a way to join the party.

They're coming to the table with vacant spec homes in a vacation area; they're bringing vacation homes that they'd love to be able to sell three quarters of; they're agents looking for new options to take to their current clients; and they're prospective buyers looking for more details on "fractional ownership".

The bottom line:

People are drawn to the fractional ownership concept because they want to have their cake and eat it too, at a price that makes sense to them. What it means to you is that this is your chance to catch the breaking wave.

CHAPTER 1 | A New Option for Selling Vacation Real Estate

A New Option for Selling

It is understatement to say the current market conditions are tough for home sellers and real estate agents. Home sales have been falling since the market peak in the second quarter of 2005. With too many sellers and not enough buyers in the marketplace, it doesn't really matter who is to blame. The great real estate bubble has burst and we need to deal with the realities we face.

Is there a way for you to tip the balance in your favor? Is it possible to do something “outside the box” to attract buyers and turn your listing into a unique opportunity they cannot resist? The answer is called Fractional Ownership.

Residential homes in prime vacation destinations have appreciated two, three and even 10-fold over the past decade and many new buyers find themselves priced out of these markets. This creates an undesirable situation for the home seller and the listing agent because the pool of available buyers is relatively small. A smaller pool of buyers and an unstable future economy means that vacation home listings sit for months and even years with little or no activity.

Fractionalizing provides a fresh perspective to the homeowner who is unable to sell a high-priced vacation home the traditional way. Fractional conversion brings affordability to the table by creating a shared ownership arrangement for buyers unwilling or unable to pay the full asking price. The seller is able to increase the pool of qualified buyers by

two, five or even twenty times because shared ownership can be had at a quarter, a sixth or even one-twelfth of the full price.

Paying for Convenience

Fractional buyers are typically willing to pay a slight premium for their fractional share. The reason they will do this is that the convenience and affordability of fractional ownership makes it worth their while.

As an example, consider the humble pizza as an illustration:

If you wanted a whole pizza you might pay \$12. But what if it's just you with a craving for just one slice? You'd probably pay \$2 for the convenience of getting just what you wanted because the extra fifty cents means you're not burdened with the cost or the nuisance of leftovers you can't eat by yourself.

For the pizza seller, the deal works equally well. He's free to sell the remaining pieces to other patrons, making an extra fifty cents per slice. At the end of the day, you get the slice you were craving and the seller earns more money than if he'd sold the whole pizza to one customer.

This reasoning can be applied to fractional sales of vacation homes. Here's why:

If you purchase full ownership in a vacation home and it sits vacant most of the year, the money you spent for the time you don't use it is wasted. If you are able to purchase one 'slice' instead of the whole pie – the amount of ownership you are likely to use – you can enjoy your home and put your savings to better use elsewhere.

A Consistent System of Fractional Conversion

Fractional ownership can be arranged in a virtually unlimited number of ways. To minimize the headaches and maximize the returns, a flexible yet standardized conversion system – one that can be applied to almost any stand-alone vacation home scenario – always works best.

With a consistent and standardized way to fractionalize a home, a real estate professional can present his or her clients with options clearly defined. They are free to sell their home the traditional way AND they can introduce a shared ownership option, often simultaneously with a full ownership listing.

The buyer is the ultimate judge and jury in a buyer's market. From a seller's perspective, offering choices is good business sense because it says to the buyer, "This deal is one in which you get to decide!"

FRACTIONAL RETREATS

The program we have designed provides a comprehensive educational resource for anyone who wants to learn more about fractional conversion and fractional ownership. At the back of this summary guide, the Resources section has a listing of the tools and training we offer with brief descriptions. More information is available on our website, www.fractionalretreats.com.

With a solid foundation in the principles of fractional ownership and a clear understanding of the benefits of uniform conversion systems, you will be able to make almost any home listing more accessible and affordable to a larger target market. Your grasp of the growing fractional ownership industry will enable you to enjoy the rewards in one of the hottest trends in the vacation home market today.

With the ability to fractionalize a stand-alone home and offer it to multiple buyers, you are able to offer something unique that speaks to the emerging needs of today's marketplace.

CHAPTER 2 | Fractional Ownership Analysis & Trends

This chapter gives you the language and statistics specific to this niche market, identifying concepts and outlining their relevance in today's economy.

Residential Market

The National Association of Realtors gives us a picture of the declining state of the residential market today. Existing home sales in 2007 were 12.8% lower than in 2006. Sales in 2006 were 8.5% lower than in 2005, when the industry was at its peak. This represents 21.3 % drop. Because sales inversely affect inventory, current inventory levels were higher than last year with “months of supply” growing from 6.5 months to nearly nine months of unsold inventory.

Second/ Vacation Home Market

While no one can predict the future, we can examine the current situation and look for potential opportunity and growth. What we see is that while the broad market is in a general decline, the vacation home market is gaining ground.

Second home ownership, and specifically vacation home ownership has been in a growth phase recently. With many baby boomers enjoying their peak earning years and even more entering the empty nest phase of life, there is a “perfect storm” brewing in terms of the future potential in the vacation home market.

From the National Association of Realtors, former Chief Economist and Senior VP David Lereah talks about the relationship between the second

home market and baby boomers: (5/11/06) *“Middle-aged, middle-income households are the driving factor in the second-home market with favorable demographics providing a solid fundamental demand in this sector for the next decade. Boomers believe in diversifying their assets and most second-home owners see their purchase as being a better investment than stocks.”*

A 2006 survey confirms his findings with 40% of home sold in 2005 being second homes, this was an increase of 36% from 2004. This percentage represented more than 3.3 million new and existing home sales.

Changes in tax laws and low interest rates

Tax law changes allowing home sellers to exclude up to \$500,000 from capital gains taxation (on primary residences) means that these funds are now available to be invested in second homes. In addition, low interest rates provide ease of financing, which means more people are able to invest in more homes.

Private Fractional Arrangements

Private fractional arrangements are individual stand-alone homes that are “fractionalized” so that they are co-owned and shared by multiple owners. These arrangements can be arrived at in a number of ways:

- A group of family/friends can come together and purchase a home jointly,
- A seller can sell a portion of his ownership and take on additional owners,
- A small independent builder can purchase or build a home (or small group of homes) and then sell it as a fractional development (NOTE:

when it becomes a large scale luxury development it is called a private residence club).

- An independent company or real estate professional can facilitate the creation of a fractional arrangement (conversion) from a standard full ownership home.

Just as there are different ways to arrive at a private fractional arrangement, the details of the arrangement can be equally diverse. As a general rule, private fractional arrangements consist of between four and thirteen owners, with fewer owners being the norm. These owners share the costs and responsibilities of the management and ownership of the vacation home.

Private Residence Clubs (PRCs)

Private residence clubs sell deeded ownership interests in luxury vacation homes located in planned development settings. They focus on luxury accommodations at top resort destinations like Vail, Colorado and Sun Valley, Idaho. These developments are predominately self-branded. A handful of well-known luxury hotel companies such as Ritz-Carlton, Four Seasons and Marriott have their own branded private residence clubs as well.

Private residence clubs typically appeal to an affluent clientele who desire high levels of service and amenities with their vacation experience. The type of high end service these clubs offer includes valet parking, 24-hour concierge service and oftentimes a personal chef. With these luxuries comes a high per share price tag as well. Prices range from \$300,000 to well over a million dollars, depending on share size, location and amenity level.

Destination Clubs

Destination clubs differ from private residence clubs in two ways:

1. A destination club is based on a membership arrangement and no deeded interest is exchanged.
2. Members of a destination club pay for use in a network of homes across the world rather than having ownership in a single dwelling.

Destination clubs attract buyers who want a diverse vacation experience and a high level of luxury accommodation. In general, members are not as concerned about deeded ownership as their private residence club counterparts. Exclusive Resorts and Quintess are two examples of this category.

Timeshares

In general, timeshare buyers are buying a very small slice of time (one to two weeks is common) in a large resort development. Accommodations are typically one or two bedroom condos. Owners often have exchange options with other locations. If there is a deeded interest associated with the timeshare purchase it is often of no consequence and because of the very high front-end sale charges, the buyer has little hope of appreciation.

Fractional Ownership vs. Timeshare Ownership

Fractional ownership products (private fractional arrangements and private residence clubs) are often lumped together with timeshares. There are four key differences that set them apart:

1. Share Size
2. Entry Price
3. Level of Accommodations

4. Deeded Ownership/Appreciation

1. Fractional Share Size In general, a fractional ownership arrangement is defined as having less than 13 ownership shares available. The minimum amount of ownership is typically four weeks, which equates to a 1/12th or 1/13th ownership share. 2. Fractional Entry Price Fractional arrangements take a vacation home and make it more affordable relative to full ownership of similar homes on the market. They bring down the entry price and ongoing maintenance costs by introducing other owners into the equation. Entry prices can range from \$50,000 to well over a million dollars, depending on the size, location and use of the home. The average price is typically between \$100,000 and \$500,000, putting fractional ownership within reach of most upper middle class families and some middle class or average income families with a high net worth.	1. Timeshare Size In a timeshare, buyers receive a very small deeded ownership or “points” that can be exchanged for time in various locations. The ownership share will typically equate to one week of use (a 1/52nd ownership share). 2. Timeshare Entry Price Timeshares are often sold through the use of high pressure tactics that play to the impulse buyer. For real estate to be an impulse purchase, most consumers look for a price point that is very low. Timeshares are structured with so many owners for this very reason – to keep the entry price affordable. When you slice up a condo development by unit and then again by time, you are creating a very low-cost product. Even with the high sales and administrative costs associated with timeshares, prices will typically be under \$20,000 and will more commonly
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Fractional products are more like traditional full ownership homes, in that they are not impulse decisions for most consumers. In fact, many fractional buyers can buy the same home outright but choose not to, because they realize they won't be getting their full money's worth with the amount of time they plan to spend in the home. They look to fractional ownership as a logical alternative to second-home ownership because they can pay much less without compromising on the quality and location they desire.	be in the \$5,000 to \$15,000 price range.
3. Fractional Accommodations Fractional ownership arrangements are quite different. They typically consist of stand-alone homes with three to four bedrooms. This creates a more convenient arrangement for larger families and extended stays. Private fractionals are identical to full ownership homes. The décor and fittings are driven by the target	3. Timeshare Accommodations Timeshares are generally condominiums that are part of a resort development. They are often one or two bedrooms with a “lock-off” unit that can create a one-bedroom / studio configuration. They are aimed at small families, couples and individuals as a hotel room alternative.

buyers and their expectations at a particular price range. The furnishings for a \$2.4 million vacation home in Aspen will be much different from a one bedroom condo in a second-tier resort development in Mexico.

Fractional buyers are looking for the second home ownership experience in a level of home that matches their lifestyle. They have no desire to compromise simply because they are on vacation. If they are buying an alternative to full second-home ownership, they don't want to compromise on the deeded ownership and appreciation that make fractional vacation home ownership so attractive and timeshare ownership less so.

4.Deeded ownership/Appreciation

Deeded ownership in a fractional arrangement is much more tangible than in a timeshare. Fractional owners will have a fee simple deed in an amount that equals their ownership share of

4. Deeded Ownership/Appreciation

Deeded ownership goes hand in hand with share size. For timeshares that offer deeded ownership, the actual share is either 1/52nd of the individual unit or a much smaller share of the

between 1/4th and 1/13th of the full deed. Fractional ownerships are tied more to the underlying real estate and will appreciate approximately the same as the surrounding real estate market for similar homes. While there are additional costs involved in creating and selling the original fractional shares, they are nowhere near as high as timeshares and depend on the type of fractional arrangement purchased. For example, private residence clubs, because of their emphasis on service and amenities, will have a much higher markup than a stand-alone fractional that was created between friends and is self managed.	project itself (1/1000th, for example). This does not lend itself to appreciation, even if the markup was not a factor. In nearly every timeshare development, the developer needs to charge huge markups for timeshare ownerships. If you are a real estate agent, imagine selling the same home 52 times! All of these costs go into the product price. As a result, timeshare owners have had a difficult time when it comes time to sell. Due to sales markups, many timeshare owners have had to discount their timeshares by as much as 50% to sell it on the secondary market.
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Private Fractional Arrangements versus Private Residence Clubs.

There are a few key differences and many similarities between private residence clubs and stand-alone private fractional arrangements. The two are similar in the following ways:

Deeded Ownership

Buyers hold ownership in the form of a tenants-in-common fee simple deed. In some instances, especially with international property, the ownership may be held in an LLC (Limited Liability Corporation), but in

general, actual tenants-in-common deeded ownership is the norm. This is also necessary from a bank financing point of view when an owner is considering a loan on a fractional share.

Accommodations

Many private fractional arrangements will have upscale furnishings and décor. It all depends on the home. Private fractional arrangements can be anything from a sparsely furnished cabin by a lake to a multimillion dollar estate. The norm will more typically offer large three and four bedroom stand-alone homes.

Price Range

While the price can be the same and the accommodations comparable, the difference is the amount of ownership you get. At a private residence club the purchase price might buy a 1/12th or a 1/10th share, while in a private fractional arrangement it will buy 1/6th or 1/4th ownership. Buyers get more time but less service and amenities.

The two products differ in the following areas:

Service and Amenities

They depend heavily on how the home was originally set up and the menu of services offered by the current management company. Some are designed for luxury accommodations and will include many of the same services and amenities as a private residence club. These fractional arrangements require a professional management company to facilitate the owners' vacation experience. On the opposite end of the scale, many fractional homes are set up for simplicity and self-management and offer owners no services and few amenities. Often these are full ownership vacation homes shared between friends and family. It is difficult to have

a fractional vacation home with a multitude of services and amenities without the help of an outside manager of some sort.

Reservations

Ideally, the more money spent to design and build a development, the more attention is paid to the reservation and use system. In simple fractional arrangements with a rotating calendar, no reservation is needed; owners simply use their assigned week. If they can't, for whatever reason, they are often allowed to rent out or exchange weeks.

Fractional Ownership Industry Sales Trends

The fractional ownership industry is starting to move into the spotlight as more and more consumers, developers and real estate professionals realize the opportunity available in the industry today.

Sales of fractional shares in 2007 were 2.5% higher than in 2006 while existing home sales dropped 12.75% during the same period. Even though 2.5% could not be considered substantial growth, it illustrates the fact fractional sales are trending slightly upward while the broader market is headed significantly lower.

Market size is also growing. The current estimate for the fractional industry is \$1.687 billion — nearly a 55% increase from only three years ago when industry sales were \$1.092 billion. This total does not include single home private fractional arrangements or small fractional developments defined as fewer than five units, but is focused solely on large fractional developments and private residence clubs.

CHAPTER 3 | Why a Seller Would Want to Sell a Home Fractionally

Selling a home fractionally is not as simple as selling a home to a single owner. Depending on the details of the transaction, a fractional sale can be very complex. Why then, would sellers be willing to subject themselves to the additional headache and burden of listing and selling their home to multiple owners?

- 1.** They want to keep a portion of the ownership for themselves. Maybe they enjoy the home but aren't using it as often as they thought they would. They could be looking to reduce some of the costs associated with full ownership.
- 2.** The seller is looking for ways to attract more buyers to the home. This is most likely because the home isn't selling to traditional full ownership buyers. To put it another way, the seller wants to make the home more affordable and expand the pool of available buyers so the home will sell faster.
- 3.** The seller doesn't want to discount the price (in a slow market) or is looking for greater profits (in a upward trending market).

Regardless of the seller's initial reason for considering fractional conversion, all three objectives can be accomplished by fractionalizing, so let's examine each one in more detail.

1. Seller Keeps Partial Ownership in the Home

This is first on the list because it is truly one of the unique advantages of fractional ownership. Sellers who enjoy owning and visiting their vacation home,

but for whatever reason believe they need to sell it, now have another option. They can sell a piece of their home and retain only the amount of ownership they actually use. This option is an amazing revelation to most sellers. Unless it was purely a short-term purchase, most sellers expect to keep their vacation home for many, many years so it is quite a heartbreaking decision to have to sell it.

With fractional conversion, they may not have to. The “ah-ha moment” is the realization that they can keep a portion of the ownership themselves while selling the rest. If they only stay two months out of the year, they can keep two months of ownership and sell the other ten. This will relieve them of over 83% of the ownership costs! AH HA!

When the home seller wants to keep a portion of the ownership but does not have enough equity in the home, there are still options. Admittedly, most sellers with zero equity will probably be more interested in selling outright, but many vacation home owners are emotionally invested in their vacation home and are only selling because they are forced to. For these sellers, a small but growing number of fractional lenders will lend on fractional arrangements. Fractional lenders will treat the seller exactly as they would a new fractional buyer. They will require all of the same lender paperwork requirements and loan fees. This is not necessarily bad, just something to keep in mind. The seller’s original loan will need to be removed and a new fractional loan put in place.

Finally there is a hybrid scenario in which the seller has some of the required equity but not all of it. In this case, the seller will need to pay off the loan through the sale of fractional shares. The owner can either take on a fractional loan or pull the additional money from another source such as home equity in a primary residence or savings.

2. Make More Affordable / Attract More Buyers

When there are more buyers than sellers there is little need to reduce the price or engage in extended negotiations. One of the benefits of fractional conversion is the ability to make a home more affordable to buyers. They do this by lowering the entry price hurdle for potential buyers through the creation of a shared ownership arrangement.

Only a handful of buyers exist in the market for a \$1.2 million vacation home. However, when you leverage the power of shared ownership, you can create a situation where you can offer 12 buyers one month of ownership for only \$100,000 apiece. This dramatically changes the economics of the transaction. Now instead of trying to locate a single buyer with the capacity and desire to pay \$1.2 million for a second home, you are locating 12 buyers with \$100,000 to spend on a vacation home — a much more likely scenario.

The goal is to get the greatest number of buyers interested and one way to do this is make the home appealing and affordable. The act of sharing ownership makes it affordable and a well designed and implemented fractional conversion plan makes it appealing. The beauty of fractional ownership is in its flexibility. No matter what your preferences, there are fractional ownership options to suit you.

Greater Profits / No Price Discounting

With the ability to offer a fractional ownership option buyers can be found, not by lowering the total price, but by lowering the individual buyer's entry price. For the seller, this means they can offer a fractional ownership option that divides the asking price by the number of fractional buyers (plus a small premium to cover fractional conversion

costs). The end result is that the seller does not have to discount the price and the buyers get ownership in a home that they otherwise could not afford. In an upward trending market, the seller may add a small premium to the fractional sale price. How big a premium is whatever the market will bear. For a private fractional arrangement the markup will typically be a factor of 1.1 to 1.3 applied to the base real estate price. Every situation is unique but this will often include the furniture, setup, marketing, selling costs and legal expenses. Most buyers will accept a markup because they are getting access to a “slice” of something they would not otherwise have access to.

CHAPTER 4 | Why a Buyer Would Want to Buy a Fractional Vacation Home

Deeded Ownership and Peace of Mind

Fractional owners hold title under a tenants in common arrangement. This is different from the way most people hold title to their primary home in that, with tenants in common ownership the deed is shared between multiple owners. Furthermore, one owner's debt obligation belongs to that owner and no other. The owner of a fractional vacation home can hold his deed free and clear with no debt or he can have a fractional loan on his portion of the home, it's his choice.

Fractional owners hold deeds to something tangible. This is in sharp contrast to timeshares and destination clubs that for the most part offer "memberships" or "points" that give buyers the right to use the company's assets. Peace of mind comes with ownership, not membership.

Another beneficial aspect is that if the market is rising and home values are increasing, the owners of a fractional home will benefit just like the owners of full ownership homes. This is an enormous advantage to owners who maintain actual deeded interest, like those found in fractional arrangements.

Pride of Ownership

Pride of ownership can be framed as the difference between owning something mediocre and owning something worth talking about. If one homeowner spends \$200,000 to acquire 25% ownership in an \$800,000 home and another spends the same \$200,000 to own his home outright, which owner is more likely to reap the greater reward? Which one will

bring friends and family to share quality time at his upscale vacation home?

Stress Free Ownership

In a properly set up and managed private fractional arrangement, the owners should be able to obtain the same level of “stress-free ownership” as any member of a destination club or owner of a high-end private residence club fractional because the services designed to eliminate stress and keep the owners happy should be at the top of the list of any fractional management company.

Central Family Gathering Place

One the main benefits of fractional ownership is getting “more bang for your buck”. When put in the context of a “central family gathering place,” fractionals offer a terrific option for today’s far-flung families because they provide ample room for everyone to rest, reconnect and relax. A fractional ownership in a Large, well-appointed vacation home has no excess family clutter; it is close to an abundance of recreational activities; the maintenance and management headaches are taken care of; and, unlike hotels and vacation rentals, the owners enjoy equity and appreciation potential.

Cost Savings

One of the great aspects of fractional ownership is that it lowers the entry price of luxury and high-priced homes to a level within reach of nearly anyone with the capacity to buy a traditional full ownership vacation home. This is a huge benefit to sellers as well, because it allows them to appeal to individuals who would not have been targeted as prospective buyers. The savings are found in two areas: the initial purchase price and the annual “carry costs” of the home.

Some people argue in favor of whole ownership with a rental scenario to offset the costs, but studies conducted by the National Association of Realtors indicate that while the average vacation homeowner typically spends fewer than 60 nights a year in their home, 75% of vacation homeowners DO NOT rent out their homes and of the 25% that do, the average number of rental nights per home is 12.

Appreciation is the reason why many owners are paying high annual carry costs. They expect appreciation to make up the difference in what they are paying today and what they receive when they sell. When you examine the annual carry costs for full ownership of nearly three and a half times the fractional ownership costs, the amount of appreciation would have to be substantial to offset an owner's costs and make it more favorable to own the home outright.

Aligning Use and Costs

The question to examine is: why would a buyer want to pay for access s/he is unlikely to use? It doesn't make sense to take on the full burden if the use is realistically going to be 25% of the time. This is the thinking behind aligning use and costs. If a buyer thinks about it logically, 25% is three months a year. That is a lot of vacation time for most people. So why not purchase the amount that you will use? If you can escape for three months a year, go for a quarter share and match your use with your costs and put your excess funds to work elsewhere.

Diversification

Many people choose the fractional ownership of vacation properties as a way to diversify because they not only diversify their financial assets, they also gain something they can use for vacation and recreation

purposes as well. Another way to diversify when it comes to fractional ownership vacation homes is by purchasing fractional interests in multiple homes instead of just one. The thinking here is that a family that can purchase one \$800,000 home would be smarter to purchase three or four fractional homes for the same price.

CHAPTER 5 | Use Strategies

The fact that fractional homes are owned by more than one owner necessitates a strategy for fair and equitable use of the home between owners. With a typical fractional having between four and 13 shares, the minimum use allocated to each share annually should be four weeks.

Generally, the lower the price, the more shares offered. A \$400,000 home might have quarter shares available while a \$1.2 million home might offer 1/12th shares for the same price. A quarter share owner will get 13 weeks in the \$400,000 home, while the 1/12th share owner will get 4 weeks in the \$1.2 million home. Different scenarios work depending on the buyer's use and desire for luxury.

While fractionals can have an equal share to owner ratio, often they do not. This is one of the huge benefits of fractional ownership. Owners can purchase the number of shares they require to match their estimated use of the home.

In most cases, a use strategy will keep a number of weeks in a 'space available' pool. This helps in cases where the home is in high demand and also allows the maintenance team to clean and repair without disturbing an owner's allotted time.

While the price and type of home influence the fraction size, a related question is the anticipated use and travel patterns of the buyers. If the buyers are local, they may want a larger share of ownership so they can visit the home on a regular basis. On the other hand, a home that is

located a significant distance away will likely attract owners who want a smaller fraction size because they won't visit the home more than once or twice a year.

Distance also dictates how the home is used. A family that drives will bring more “stuff”. Families that fly will travel light, so they will want more amenities provided. A family that brings a boat or horses when they drive in the summer may only bring skis when they fly in winter.

One convenient amenity included in most professionally managed fractional homes is onsite storage options for owners — either built in cabinets (one for each ownership share) or an off-site storage service. This is useful for owners who drive because they won't need to pack so much into their vehicles.

Use Systems: Fixed-use

A fixed-use system is similar to what most people think of when they think timeshare. Basically, it is a set period of time each year that the owner gets to use the home. This can be as short as a week in the case of timeshares or up to and exceeding a month.

A fixed-use system would include blocks of time the owners purchase when they first set up the home. A system of fixed-use might include 12 owners with four weeks and the remaining four weeks allotted to “space available/maintenance”. One owner might get the first week in January (week 1), one week in spring (week 10), a week in summer (week 24) and a week in fall (week 37). The actual dates will change from year to year but the owner will get to use the home at approximately the same time each year. This type of system allows owners to plan in advance and it requires very little work to manage.

The drawback in a fixed system is the lack of flexibility. If the weather is bad (or the golfing is good!) the owner may want to extend his stay. Other owners may not be willing to trade.

A system broken into weeks may not work for owners who want to spend their time in one continuous visit. This alternative arrangement could be arranged at the time of purchase if it is agreeable to the other owners.

The fixed-use system does not allow for spontaneity either. There is no “pool” of time that can be acquired for a last minute trip, which means that owners need to plan well in advance.

Use Systems: Rotating Calendar

In a rotating calendar system, each owner’s time rotates throughout the year in an order from first owner to last and then back to the first. The system typically shifts by some predetermined period each year so that eventually every owner will have every week of the year (including holidays) at least once. This system is most often used in homes that have fewer owners and is very easy to administer.

The rotating calendar system is simple to manage and fair to everyone. For owners who like to spend more than their allotted week at a time, however, the same drawbacks exist as in a fixed-use system.

Use Systems: Rotating Priority

A rotating priority system is one of the more management-intensive systems, but it is also the most flexible for the owners. [Note: a good point to keep in mind with fractional ownership is that flexibility and simplicity are inverse of each other.]

In a rotating priority system, instead of the time rotating as it does in a rotating calendar, the owner's priority to select the weeks they want is rotated. Unlike the previous two systems, there is no fixed time. Instead, all time is variable and owner-selectable. The order of "who goes first, second, third, etc." is rotated each year. This system works best with a larger number of owners.

Use Systems: Space Available Pool

The time that has not been allocated is added to a space available pool that can be drawn from by anyone. In some systems anyone can pull as much time as they want as long as they are the first to get in the reservation. In another variation, space available use is based on priority. In another variation, the time is only available one week before use and whoever wants it can take it.

Adding a space available pool of time is an especially good option for fractional arrangements with a greater number fractional shares (eight to 13) because it makes the use system more flexible to a wider number of owners.

Use Systems: Hybrid Systems

Use system for fractional ownership is limited only by the owner's imagination.

Pay to Use: In this system, no time is pre-allocated to owners. Instead each owner pays a specific amount to use the home.

Unlimited Use: With an unlimited use system, owners are allowed to use the home as much as they like. There are no requirements other than the need to reserve the home using the reservation method established by the owners.

Anytime Use with a Cap: Use cannot exceed the owner's allocation in a calendar year.

Midweek Use: Some systems will add a mid-week component that allows owners to use the home Tuesday through Thursday, while others use the home for Friday through Monday long-weekend getaways.

Fixed Month: Owners can buy an entire calendar month for use. The price of the calendar month is often higher for peak season and lower during off-peak and shoulder seasons.

Seasonal Pricing: As above, except this is a weekly deal.

Fixed-week with Season Limitations: Buyers to purchase a set of weeks they want but are limited to the season for each selection.

Spontaneous Use: Owners have the ability to use the home if it has not been reserved one week prior. This is in addition to the owners' planned weeks.

Variable Time: Time blocks are customized by season. A home could have one week maximum increments during peak season, two weeks maximum during shoulder and four week maximums during off-peak.

Reservation Systems

Reservation systems range from no reservation plan to complex phone or web-based interfaces. The type of reservation system will depend in large part on the degree of management required to operate the use system as well as its cost.

In most simple fractional arrangements, there is no reservation system because the use system is arranged as a fixed use or rotating calendar system. All owners already know their dates for use so there is no need to make reservations.

If the fractional is set up with a fixed use or rotating calendar method, owners will inevitably want to swap time with one another, so even in this low management approach, some sort of facilitator is needed. One of the best ways to handle these scenarios is to have a manager who handles all reservation requests.

If the use program is reservation based, there will need to be a way to call or electronically notify the manager and for the manager to respond about the availability of that time. This is a relatively simple process and can be handled easily by most managers. The degree of complexity required is a function of the use requirements of the owners. Once the decision for professional management has been made, the cost of the system should be taken into account. A simple system may be more labor intensive. A web-based system will require a larger upfront fee on the part of the owners but will incur lower ongoing expenses.

CHAPTER 6 | Marketing

This section is of specific interest to real estate professionals and listing agents in particular. Due to limited publicity about fractional ownership, many buyers are unaware of the opportunity and this makes the realtor's job more difficult. Not only do they need to educate buyers about the specific home, location and amenities, they also have to educate the buyer about the opportunities afforded them through the concept, special features, use and management of the home as a fractional ownership arrangement.

Fractional ownership is well received once it is understood. It is simply getting to that point that is the challenge. As of this writing, MLS services do not have a separate way to list a fractional that is simultaneously being offered for full ownership. It can be listed one way or the other and this causes confusion in the minds of many buyers.

Unique Nature of Fractionals

From a listing perspective, fractionals present some unique hurdles. The MLS issue aside, they are not typically targeted to local buyers, which adds to the challenge of finding prospects.

Fractionals can be listed just like traditional real estate in the classifieds or on the MLS. The confusion that frequently arises is that because it is a relatively new concept, potential buyers either don't understand the ad, think that there's a misprint or that it looks like a deal that is too good to be true.

When prospective buyers look at fractional ads, their focus is whole ownership. Without knowing the benefits a fractional arrangement offers

them, they are distrustful or even feel deceived when they contact the listing agent and discover that the home is being offered for fractional ownership at the stated price.

A listing agent needs to make every possible effort to indicate that the home listed is indeed offered as a fractional ownership home. Again, MLS has not yet caught up with the trend. Their “notes” section is not carried to all listing websites because of liability reasons. This means that, in some cases, there is no way to indicate to buyers that the listing is a fractional.

Aside from the listing service-related peculiarities of fractionals, another unique characteristic is the fact that buyers of fractionals will generally not be local. They may be from anywhere in the country or, now that the dollar is weak and foreign buyers are entering the market, the world and you need to market your properties to a much wider audience than ever before. Comprehensive, detailed marketing material is necessary for selling fractional vacation homes, especially if the target market is geographically distant.

Educating the Consumer

Educating potential buyers about the nature of fractional ownership should take priority over other marketing techniques. Buyers need to understand the special benefits and tradeoffs that fractional ownership provides.

One way this can be accomplished effectively is by creating an FAQ about fractional ownership that is sent to potential buyers — even those who initially indicate no interest in purchasing a fractional. How many times have you seen people turn their noses up at something before they knew

anything about it? It is a natural tendency to fear what we don't understand. Plus, many people are intellectually lazy and if they have to take the time to learn about something new they would much rather walk away.

Fractionals are a cutting edge product that few realtors and fewer consumers know much about. Remember, you will know more than 95% of your colleagues when you've finished reading this booklet!

Educating Other Real Estate Professionals

One of the best ways for a real estate professional to get exposure for his or her listing is to talk with other agents and inform them of this unique option available to his or her buyers. There are likely many other agents in the market, especially if it is a resort or vacation community, who have potential buyers approach them with between \$50,000 and \$250,000 to spend on a vacation home. These buyers will have dreams of grandeur and will get hit with a reality check when they see what is actually available in their price range. This is especially true for resort locations that have recently gone up in price.

These other agents can be a fantastic source of potential buyers once you've educated them to the opportunity that fractionals represent. If the buyer's agent is able to explain the positives and tradeoffs to his client, that is one more buyer you won't have to educate yourself so it pays to create a network of other agents interested in learning the details of fractional ownership and how the concept can help their business.

Marketing Materials

For full ownership homes listed simultaneously as fractionals, one of the best things the marketer can do is to have flyers or pamphlets available inside the home for distribution to any interested buyers who walk through. These flyers should have information about fractional ownership as a viable form of vacation home ownership and include the benefits and tradeoffs in broad terms. It would be a good idea to have an FAQ as part of the material.

Online Marketing

One very good way to market fractionals is online. With a webpage dedicated to the home listing there can be a description of the home as well as links to detailed information about the fractional arrangement.

A website is much more flexible than print because it can contain links to outside websites with more information, downloadable print material, contact information, pictures, video feeds etc.

Drawing Traffic

With print and online material in place, the next step will be to draw traffic to the listing. Listing agents should look to target three distinct groups depending on their geographic distance from the home they are marketing:

1. Potential customers visiting or vacationing in the area.
2. Potential customers who live within the same region (8 hour drive).
3. Buyers who would be willing to travel long distances.

Strategies aimed at local vacationers: The advertising goal with this segment of the target market will be to grab the attention of customers currently visiting the area and either staying in hotels or renting vacation homes on a short term basis. This group will need to be educated on the

benefits of fractional home ownership and shown the options available in the area.

Strategies for residents living within an eight hour drive: You will need to sort out the target market from the general population and get the marketing message in front of them with pictures and vital statistics whenever possible.

National advertising: The goal of this strategy is to attract customers regardless of where they live because fractional buyers are not geography-specific. These strategies are more costly but can be used when the price of the home dictates:

- Magazines: Advertising in periodicals that cater to the target market
- Newspapers: Papers with national circulation
- Internet: Websites and banner ads on relevant sites

Who buys fractional ownerships?

The typical fractional owner belongs to a larger segment of the population than you might think. In effect, anyone who wants to leverage their buying power is a candidate. But let's focus our attention on those people who are your best bets:

Age: The target range is 45 to 55: the “new empty nesters.” Members of this group will typically have disposable income, an ability and desire to take extended vacations and a need to bring the family together.

Income: Between \$150,000 and \$250,000. This income range provides enough disposable income to purchase a fractional and maintain it year after year, but not quite enough to buy a similar home outright.

Marriage Status and Education: Fractional homes are geared more toward families and education corresponds with income, as a general rule.

Older Children: Older children are more a function of the primary buyer's age range of 45 to 55 than anything else.

Owns Primary Home: Most people don't buy vacation homes unless they own a primary home. Many homeowners take out a home equity loan instead of taking out a loan from a fractional lender.

Distance from Fractional: In general more owners drive to their fractional vacation home than fly. This will depend on many factors, including use rights in the home. If a family has one month a year in another country, they will likely fly, but most fractional use patterns are more spread out and are aimed at families that can travel to the fractional by car.

CHAPTER 7 | Lenders & Financing

In a chapter on financing, it makes sense to state the bottom line right up front: Fractional lenders make it possible for families to own a slice of their dream without having to come up with the full fractional asking price up front.

Until recently, buyers were unable to purchase fractional vacation homes using the fractional as collateral for the loan. They had to use their primary home for collateral or use other assets, such as securities or bonds.

Traditional lenders were unable to put a loan on the fractional because the whole deed was necessary to secure the loan. If the lender had to foreclose for some reason they had to have assurance that they would be able to sell the whole home to recoup their costs. If the lender did not possess the entire deed, how could they sell the home and recover their loan proceeds?

All that has changed with the creation of Fractional Loans. A fractional loan is a loan on a fractional share of the home. It is secured by a partial interest in the deed. Typically the amount of the ownership can't be less than 1/12th or 1/13th so it is perfect for private fractional arrangements.

There are more stringent requirements and they also tend to have higher fees. Fractional loans have significant documentation requirements, due to the fact that the lender is not obtaining an entire deed as security to the home. As in financing a condominium, the lender must be comfortable with the stability of the fractional arrangement.

Lenders also expect a professional management company to be in place to safeguard the owners' interests and provide any services originally offered in the marketing material.

If fractionalizing a home made it more affordable to buyers, then a fractional loan makes it even more so. A seller should look into getting a fractional loan quote as part of the marketing process.

Comparative Financing

When you put together your marketing material, include the loan requirements and fees and compare them to a whole ownership scenario so that prospective buyer can easily see the benefits of fractional ownership as opposed to whole ownership. Work up the sample based on the home's fractional asking price so potential buyers can get a per month figure to walk around the house with, saying to each other, "We can have all this for only \$983 a month? Incredible!"

Fractional Conversion Loans

A fractional conversion loan has a partial release deed associated with the home, eliminating the drawback of a conventional loan when applied to a fractional arrangement. This deed allows the seller to release fractions to buyers as they come up for sale. In many ways, a fractional conversion loan is similar to a commercial loan: it will have a very short duration and is likely initiated without repayment of principal. Fractional conversion loans will require the following:

- HOA By-Laws / Owner Agreement
- 1st Year Budget and Operating Statement
- Property Management Agreement
- Tenants in common Agreement

- CC&R's from Master HOA Community
- Marketing Plan for Selling Fractional Shares
- Deed Restrictions to the Property
- Title Exceptions from Title Commitment

While the homeowner pays more for a fractional conversion loan, the seller has the ability to sell fractional shares in the home without any delay. There is no need for a simultaneous closing.

Always keep in mind with fractionals the characteristics of debt. If there is a traditional mortgage on the property it cannot be fractionalized until that debt is removed. It can be removed by the sellers if they have the funds or it can be removed once the funds are contributed by the appropriate number of buyers, but it has to be removed.

Added Flexibility — Higher Risks

Fractional conversion loans are not for every seller because there are higher risks involved. If the seller can find only one buyer for his quarter-share fractional arrangement, he will have to carry the other shares until buyers can be found. The flip side is that many homeowners who create a fractional arrangement with a fractional conversion loan want to keep part ownership for themselves.

CHAPTER 8 | Legal Considerations

There are special ways fractional ownership needs to be marketed so as not to cross the SEC: certain ways to hold title, specific legal documents that need to be obtained and, of course, problems that arise from group ownership. This means that to avoid the pitfalls, you need to be prepared.

As you know, the four most common ways to hold title to real estate are:

1. Joint Tenancy

The main thing to remember about joint tenancy is that the interests of the owners are equal. Upon the death of any owner, ownership passes from that owner to the other owners without the need for a will or probate. The heirs of the deceased owner do not have a claim on the property.

2. Community Property

Community property is recognized in Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. It is very similar to joint tenancy but only applies to married couples and eliminates the right of survivorship component of joint tenancy. This means that an owner can designate his or her heirs to receive that owner's interest in the property instead of the other owner(s).

3. Sole and Separate Property

Under this form of deed ownership a person may hold the title as the sole owner without anyone else having a claim to it.

4. Tenancy in Common

With TIC ownership you have a way for partners to join together without actually forming a company. Documents must be created between the parties to define the rights of each owner, but no formal LLC, LLP or corporation need be created and each owner is legally distinct and separate from every other owner.

With fractional arrangements there is also a fifth category:

5. LLC's and Partnerships

Some fractional ownership groups create a business entity to purchase the property as a partnership or LLC (Limited Liability Corporation). This is useful because there is a level of liability protection for the owners. The drawbacks are the tax laws and financing hoops to jump through.

The SEC and Securities Laws

Unique laws apply to fractionals that don't apply to traditional real estate sales. Since a fractional is an asset that is broken up and sold to multiple buyers, it has some of the characteristics of a security. Certain laws that apply to securities could potentially apply to fractionals if the seller is not cautious.

If the fractional arrangement can be considered a security, the Securities and Exchange Commission (SEC) could have jurisdiction over your fractional arrangement sale. If it was determined that you were selling a security without a license you could be fined or put in jail! This is why it pays to do your homework.

Okay, let's take a closer look at this. You probably already know that there are commercial tenants in common (TIC) properties that are considered securities. A whole range of 1031/TIC investment products

out there are aimed at both small and large investors to help owners of certain types of property defer capital gains taxes when they sell. In a similar way, the IRS has deemed certain fractional ownerships as Securities in certain situations.

The primary difference between commercial tenants in common properties and those purchased for leisure activities is that the main goal of a vacation home is not investment income, it is enjoyment.

A fractional vacation home should be purchased as a “lifestyle choice,” not primarily for investment. The wise realtor will do well to emphasize this for a number of reasons:

- 1.** There is no guarantee that the buyer will make a profit on the home and is often better off looking at dedicated investment products.
- 2.** The rental income is just a fraction of the overall possible rental income from a full ownership home, even if the buyer rents the fractional during all of his use periods.
- 3.** If potential revenue streams are promoted as the primary reason to buy a fractional home, the SEC is almost guaranteed to scrutinize the project as a potential security.
- 4.** Another SEC red flag is rental income pooling. Traditional securities, like mutual funds, pool income to distribute to investors. Fractional arrangements typically do not do this. Some do, and that makes them a little closer to a security in the eyes of the SEC. Some fractional arrangements, especially those similar to condo-hotels have to be careful here because it is easy to cross the line.
- 5.** Another point to consider is the role of the manager and the control allocated to the owners of the property. If the manager is hired to significantly increase the value of the property, perhaps through a rental program, it looks a lot more like a security. That is the role of a mutual

fund manager, after all. If an agreement requires the owners to allow the manager to rent out the home or unit when it is not occupied, this is a red flag for the SEC. An owner should be able to “opt out” of a rental program.

The fractional developer or seller needs to look out for many things so there is no mistake that the property is not a security. Because this is such an important topic we'll summarize these elements for you again here:

1 The property is not marketed as an investment. There is no emphasis on potential rental or capital gains income from the property aside from the normal elements of potential appreciation. Market rates for weekly or nightly rentals are not provided. In short, the potential buyer should have no expectation of future income streams. They are buying a recreational property or a lifestyle choice.

2 The rental income is not pooled. The home is not rented when it is vacant with the income distributed or used to off-set costs. Also there is no formal rental program in place through the property management company. If there is a rental program offered by the property manager, there is no obligation on the part of the owners to be a part of it. In other words they can “opt out” if they choose.

3 The owners have discretion over the manager. They can fire him or her at will and hire another manager of their choosing. The manager's main purpose should not be to increase the value of the investment on behalf of the owners.

Necessary Legal Documents

Fractional ownership arrangements are more complex than traditional vacation home purchases. The reason for this is obvious — whenever you get a group of strangers together in a financial endeavor, there need to be

concrete rights, rules and regulations to help safeguard the interests of those involved.

In many family-created fractional arrangements, the rights and rules are very loosely defined and may not even be written down. This is a dangerous practice. Many friendships and family ties have gone down the drain due to disagreements over financial matters and a fractional home is no exception, especially since it represents such a large financial commitment for most owners. In the case of stranger-owned fractionals, a seller would have a hard time getting buyers to buy into a fractional arrangement without clearly defined documents outlining what is expected of everyone.

Co-Ownership Agreement

This document can go by many names including “bylaws”, “fractional ownership agreement”, “user agreement”, or “co-owner agreement.” The main purpose of this document is to outline the rights and obligations of the fractional owners, including – but not limited to:

- visiting the property,
- renting time,
- making decisions,
- handling disputes, and
- mortgaging and selling their ownership share.

In exchange for the fractional price they paid, each owner was given a bundle of rights that revolved around their use of the property.

In addition to these rights, there are obligations of every owner to guarantee that the ownership experience runs smoothly. Some of these obligations include:

- paying expenses,
- managing the managers,
- making decisions,
- handling disputes, and
- removing non-paying or disruptive co-owners.

A co-ownership agreement should be set up to handle nearly every circumstance the owners may find themselves in. It should be clear and detailed and should be drafted by an attorney experienced in these matters.

A list of many elements that should be in a co-ownership agreement follows:

Definitions: will include all of the terms used throughout the document.

Property Use: How the home will be used.

Reservation Procedure: How does each owner confirm his use?

Cleaning: Pertains to the cleaning schedule, prices and specific tasks.

Arrival / Departure: What are the obligations and procedures?

Damage: If the home has been damaged, who pays? How is this assigned?

Mortgage Rights: Rights of the owner upon mortgaging; foreclosure; collateral.

Management: How is the home managed? By whom? Is there an agreement?

Expense Payment: How are expenses calculated and payments collected? Is there a budget? What happens in a shortfall situation?

Expense Reserve: What is covered and how much is collected for a reserve?

HOA Board Creation: Who is responsible? How are board members removed?

Decision Making: How are decisions made?

Default: What happens if an owner doesn't pay or goes bankrupt?

Forced Sale: How do you force the sale of an owner? What is the process?

Sale of Fractionals: How can an owner sell? How is the group involved?

Sale of Entire Home: How and when can an owner force an entire sale? What is the process for distributing sale proceeds?

Pets: Are pets allowed? If so, what size or type? What are the rules?

Smoking: Is it allowed? If so, when and where? If not, what are the penalties?

House Rules / Operating Manual

Each home should have a well-thought-out “operating manual” that includes a set of house rules and step by step instructions for everything a homeowner or guest will need to know. In a nutshell, this is the first book a visitor will pick up and the last one they put down when they leave. It will include every scrap of relevant knowledge about the house and should prevent 99% of the problems associated with staying in a home that isn't a person's primary residence. Regardless of the type of fractional arrangement, whether it is a tight group of family or friends or a collection of distant strangers — having a set of rules and a standard procedures manual is necessary for a smoothly running fractional arrangement.

Management Agreement

A management agreement is provided to a third-party property manager to define his role. It should allow the owners to terminate the employment with notice but without cause. This keeps managers honest and forces them to continuously earn the property owners' business. This not only goes for performance issues but also issues of cost. If the

manager can't justify higher prices with higher level or more prompt service, the owners should be able to let them go.

NOTE: Many fractional owners who buy into pre-formed fractional arrangements are stuck with the property manager the developer has put in place. This isn't fair to the owners who have limited options in replacing the management company if they are underperforming.

Fractional Purchase and Sale Addendum

The forms that real estate professionals typically use as the basis for residential purchase and sale transactions are not specific enough for a fractional sale. Fractionals can start with the same form as most residential transactions but must also include an addendum that discloses the unique risks and requirements of a fractional sale.

One important part of the addendum is the need for the buyers to indicate that they understand and acknowledge the differences and risks of fractional ownership. Buyers need to be provided a copy of the co-ownership agreement and acknowledge that they understand the terms and agree with them.

NOTE: Please remember that this publication is designed merely to give you an overview of the basics of fractional ownership and fractional conversion. For more detailed information, including additional resources, charts, graphs, a self-test, and glossary, purchase the full 256 page print book *Vacation Home Fractional Conversion: A Complete Guide for Home Sellers, Builders and Real Estate Professionals* which is available at www.fractionalretreats.com for \$44.95.

CHAPTER 9 | Management & Expenses

Management is one of the most important functions of any real estate property not fully occupied by its owners. This is the case whether we are talking about a shopping center or a vacation home.

Due to the unique nature of fractional arrangements, the type of management to put in place becomes a priority issue. Large fractional developments simply put a dedicated staff member on site to handle all property and fractional related owner concerns. With stand-alone private fractionals, it is left to the owners to decide how the property will be run. It is very likely that each buyer in a fractional arrangement has made a significant investment in the property, not solely in terms of money paid to acquire and maintain the it, but in terms of the emotional attachment to the home and the area as well. They will want someone they respect and trust to manage and maintain their investment.

Role of a Management Company

The role of a management company is to preserve an owner's financial and emotional investment in a fractional property. The manager must have integrity, dependability and empathy for his or her clients. Without this, and the required technical skills, he will struggle to keep customers and maintain his business.

Maintenance and Repairs

A fractional property manager needs to oversee every aspect of cleaning, maintenance and repairs of the property. A poorly maintained home will decline in value and make owners think twice about bringing guests to the property. It will also create a downward cycle of disrespect and neglect, while a well-maintained home will foster a sense of pride

amongst the group of owners and lead to more care given by the owners when they are visiting the home.

A manager will need a number of competent dependable third-party vendors who can perform any/all services to maintain the home. This roster of providers will be managed in accordance with a schedule approved by the owners and in keeping with their individual needs and concerns.

Financial Management

A manager must have the authority and ability to pay vendors on behalf of the owners, who will contribute their share of the fees to the operating budget. The manager's fees will be included in this budget and paid as any other vendor. An HOA board member will need to be responsible for reviewing the monthly or quarterly transactions to ensure that nothing unusual happens in the account.

Three types of budgets should be made:

1. Recurring monthly, quarterly or annual expenses.
2. Non-recurring expenses.
3. Unexpected repairs.

Group Arbitration

A manager should also be a neutral third party who can arbitrate or negotiate between owners. A non-owning manager is in a unique position to help the owners interpret grey areas to their mutual satisfaction and come to a consensus agreement.

Reservation Management

With the different types of reservation systems come varied levels of involvement for managers. With a simple rotating or fixed week system, a

manager may be involved in facilitating the exchanges of time between owners. If the system is more complex the manager may assign priorities and reserve use preferences for each owner. If there is an actual phone-based reservation system, the manager may need to be available to handle reservation requests and check for conflicts. An Internet reservation system could have a website with an online calendar that can be accessed by owners through a password to the site.

Customer Service

For the manager of high end luxury hotels, destination and private residence clubs, responsive customer service is the name of the game. This is not usually the case when people buy a traditional vacation home. The owners simply want a getaway destination they can call their own and don't mind doing the work themselves.

Fractional arrangement owners are somewhere between the two: they expect the manager to deliver more service than owners expect in a fully owned vacation home, but less than visitors to a luxury resort or hotel. Most fractional owners won't be willing to pay the extra fees associated with bellhop and valet service, transportation to and from the airport, personal concierge and daily maid service.

Marketing

A manager may be called upon to market a home for rentals or even assist in showing fractional listings to prospective buyers. It helps if the manager is able to use current marketing tools such as the Internet to create exposure for the home. A manager who offers a rental program to owners is providing a valuable service. Fractional ownership is already a cost-effective way to own a vacation home. Couple that with the ability to

rent out some of an owner's unused time and it becomes even more cost-effective.

Two Part Management

This system is used by many institutional grade commercial properties, but it is relatively new to most residential properties.

With a two-part management system, the property manager handles the home while the fractional manager handles the owners. A company that specializes in the management of individual fractional arrangements can provide economies of scale by bringing separate and distant homes together in a network. A fractional management company could have a more flexible and complex system of reservation, a staff of customer service people, in-house accounting and legal, all designed to serve the needs of fractional owners. This fractional management company would then partner with local property management firms for the “feet on the ground” aspect so necessary to fractional owners.

The benefit of this separation is that it prevents the management companies from developing unproductive habits and keeps the owners happy because they know they are getting the best value for their dollar. If they aren't, they can vote with their checkbook and go to another vendor.

CHAPTER 10 | Taxes, Resale of Fractionals and Investment Considerations

As with any innovation, there are many questions that speak to different perspectives and needs. The scope of tax and real estate law is enormous, requiring decades to learn and master. These laws are localized (especially in real estate) and are constantly changing. Our general rule of thumb is ‘when in doubt, check it out’ with your accountant and/or lawyer.

Many of the points touched on in this chapter are of specific interest to potential buyers and are likely to come up during property tours and inquiry phone calls.

Tax Deductions

Due to the unique nature of fractionals, it is natural to inquire how they are different or similar to traditional vacation home ownership. One topic we haven’t covered is the tax treatment of fractionals.

A fractional vacation home will adhere to most of the rules that apply to a traditional vacation home and can be treated as a personal use vacation home, a rental or a combination of the two. If the home is considered to be for personal use, the only expenses that can be deducted are mortgage interest and property taxes (like a primary residence). If the home is classified as a rental, mortgage interest, property taxes AND operating expenses may be tax deductible.

To choose the appropriate category, an owner will need to know the total number of personal days and the total number of rental days allocated

during the year. Rental days include time that the home was rented at fair market value. They do not include renting the home to friends and family at a reduced rate.

Personal Use:

The home is rented for 14 days or less per year. In this case, mortgage interest and property taxes are tax deductible but no other expenses are.

Rental Property:

The home is rented for 15 or more days and occupied for personal use 14 or fewer days or 10% of the total rental days. If this is the case, the home will be taxed two ways: one for the rental portion (all expenses are tax deductible) and the other for personal use. Mortgage interest is not deductible as with a personal use home and is looked at as investment interest. Property taxes are deductible.

Combination Use:

If the property is used for more than 14 personal days AND it is rented for more than 14 days, the taxation is split between a personal home and a rental. For the portion the home is a personal home, mortgage interest and property taxes can be deducted. For the portion the home is used as a rental, all expenses may be deducted, up to the rental income amount.

Resale of Fractionals

Factors that can affect the resale of the home include: the current condition of the home, the state of the real estate market, the acceptance of fractional ownership at the time of sale and the level of desirable attributes and amenities in the home as compared to competing properties in a similar price range.

Just as with a standard home, fractional home buyers need to think about the future. They need to consider their fractional home as an investment and be aware of anything that would set it apart in both positive and negative ways in the minds of future buyers. It is a good idea to examine current local attractions and assess whether or not there is a potential for change in the future. Obviously a ski mountain or lake won't move, but perhaps a golf course is scheduled for development in two years. It's good to know about and be aware of such things.

While the resale of fractionals is a concern for many potential buyers, there is much that is under the control of the future owner. A fractional ownership share should be looked at just like any other real estate purchase. If it is undertaken in a thoughtful manner, there is no reason why a fractional owner should have any trouble with a resale. In fact as we have seen, there are even some advantages to reselling a fractional.

Investment Considerations

While fractionals can't be marketed as investments, they do provide the owner with an asset in the same way a primary home does. It is in this way that fractionals can be considered investments as well.

Resort real estate is in short supply. This is a fact. There are only so many desirable ski mountains, lakes or beaches that can be developed. Add to this the aging population, the growth of household wealth and the proliferation of mobile technology and you have a recipe for growth in resort areas. This is a trend that entrepreneurial minded individuals are positioning themselves to capitalize on and thus there is a huge opportunity for fractional owners to benefit.

If buying a full ownership home makes sense from an appreciation perspective, then buying a fractional makes even more sense. This is because a fractional owner is using additional leverage — he is purchasing something using other people’s money (and often using bank debt as well). He is now able to afford a piece of something that he otherwise couldn’t because he is buying only what he intends to use. It allows those of limited means (i.e. 99.8% of us!) a great way to get our feet in the door and “lock in” future appreciation while still maintaining annual use and deeded ownership.

Imagine: we get all these perks, plus tax advantages and we haven’t even talked about simply enjoying the property for its primary use: our dream vacation home.

FRACTIONAL RETREATS – WHAT WE CAN DO FOR YOU

Our goal is to make sure that you, the real estate professional, will be successful offering fractional ownership to your clients. To achieve this goal, we want to give you the tools and training resources you will need to create and market fractional arrangements that will appeal to buyers. Because fractional ownership is still a new concept, there is a level of hesitancy in the marketplace. Once buyers see that the fractional arrangement you present is professionally set up and will be supported well after the closing, they will be more likely to buy into the concept.

Sellers are increasingly interested in offering their homes for fractional ownership because it allows them to remain a partial owner and remove much of the cost of second home ownership. Fractional Retreats is focused on providing the tools you need to successfully introduce fractional ownership options to your clients.

We offer a much broader and more detailed manual to fractional ownership called: *Vacation Home Fractional Conversion: A Complete Guide for Home Sellers, Builders and Real Estate Professionals*. We also offer a number of services to help you offer the perfect fractional ownership options to your clients.

Book Overview:

Vacation Home Fractional Conversion is a fresh approach for a changing real estate market. This groundbreaking book will take the reader from a fractional ownership neophyte to a level where Fractional Ownership Specialist can be aptly applied. Whether you are a real estate professional, a home builder, a vacation home owner or simply dreaming

of owning a vacation home... this book will give you a solid understanding of fractional ownership and fractional conversion in laymen s terms.

Vacation Home Fractional Conversion takes the approach that the reader is part of the 99.8% of the population that does not have a firm understanding of fractional ownership and seeks to explain what fractional ownership is, how it has evolved, where it is going and how it can be used effectively in a number of situations to provide flexibility, increase profits and attract buyers.

Available from: www.fractionalretreats.com

Price \$44.95

For a \$10 Discount off of *Vacation Home Fractional Conversion...* Enter Coupon Code: **VHFC10EMR** when ordering through the website.

Our Services:

Fractional Feasibility Study (Fractional Conversion Analysis):

The first step in the fractional conversion process is what we call a “Fractional Conversion Analysis” (“FCA” for short). We do a complete due diligence on a vacation home to determine whether it is fractional suitable. Not every home is a good fractional ownership candidate and a seller can save a lot of time and headache by finding that out ahead of time. With an FCA in hand, the seller and Realtor will have a complete roadmap for converting and listing a home for fractional ownership.

Fractional Conversion Management

If additional guidance is desired we provide fractional conversion management services. Fractional Retreats brings together the experience

and resources necessary for a successful fractional conversion. Together with our contacts in banking, legal, interior design and property management we can help you create a fractional arrangements that appeals to buyers. During this process we provide complete Realtor support including a toll free number for prospective buyers to get their questions answered and marketing material that explains fractional ownership in detail.

Post Closing Fractional Management

We are able to bring in economies of scale and uniformity not found in other stand alone fractional arrangements. All of this translates into a more attractive and professional offering in the eyes of the buyers as well as less complexity for the seller and real estate professional.

The Fractional Retreats Team



Fractional Retreats was founded in March of 2007 by **Daniel G. Morton**. As an analyst of trends targeting shifts in consumer behaviors and spending patterns, Daniel became aware of the growing interest in fractional ownership a decade ago. Prior to the formation of Fractional Retreats, he spent a number of years converting commercial real estate for institutional “tenant in common” investors. Daniel has extensive experience with the commercial tenant-in-common real estate model, the cousin to the fractional vacation home model.

Fractional Retreats LLC was born from Daniel’s realization that there was an obvious need in the residential industry for a service based model similar to the one he used to fractionalize stand alone commercial properties. He applied this knowledge to launch his company and in the process create a new niche market that speaks to a rapidly growing need in the residential real estate market: fractional conversion management services.



Burma Naylor is a successful real estate agent and co-owner of Mountain Realty based in Eagle, Idaho. She has been involved in real estate for over seven years with specific experience and insights in marketing to and attracting high net worth clients. Burma brings her diverse residential real estate knowledge to Fractional Retreats as the head of Realtor relations. Burma is responsible for negotiating and contracting with third-party real estate agents across the nation.



Justin Waldron's professional career might best be described as eclectic. As a business development professional, aspiring writer, professional speaker, trainer and coach he works to help businesses understand and use networking, relationship and rapport building to establish value-added, lasting professional relationships with clientele.

In addition to working in Sales & Marketing for more than 12 years, Justin a Business Psychology major, has trained as a Hypnotist studying Neuro-Linguistic Programming, Psycho-Linguistics, and Visuomotor Behavior Rehearsal to help others reach their personal goals. He has developed a Corporate Wellness Consulting Company and has worked as a personal trainer, a personnel recruiter, a quality specialist, and a networking coach.

Justin joins Fractional Retreats, LLC out of his love for travel and real estate; also out of his passion to educate consumers on an increasingly beneficial trend in the industry.



Brian Critchfield and his team at Navel Marketing handle the marketing and branding for Fractional Retreats. Brian has over 13 years of marketing, sales, and business development experience. He has been instrumental in launching and building several organizations in the real estate, retail technology, mobile technology, professional services, and food industries. His track record includes launching and building sales forces, building sales channels, launching new divisions, developing manufacturing relationships, re-branding and re-positioning companies, and helping major technology firms launch products and develop go-to-market strategies. Before starting Navel Marketing, Brian served as the

President, CEO, Co-Founder, and Chief Strategist at Boise-based BlueLine Grassroots Marketing for 3 1/2 years.

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