

White Paper on Mid-Tier Fractions

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Mid-Tier fractions are not a new product. Maybe gussied up a bit, but they've been around for at least 20 years.

From the time second homes became accessible to the middle class, vacation homes have been purchased by more than one family. Back in 1972, doing research for Brockway Springs, which became the first, fee timeshare in the world, the records of Placer County, Lake Tahoe CA, showed that more than 30% of homes were owned by more than one family.

By virtue of timeshare documents fractions were able to 'borrow' those documents to overlay on a property to be sold in larger increments than timeshare weeks. The core benefit of those documents were that they: [a] guaranteed the rights and obligations of all owners, and [b] allowed a deed to be given to each owner instead of being a tenant in common.

In the purchaser's view both these elements were of substantial benefit. Now, their investment could be safe for personal use and ownership. So, early timeshare developers who along with their lawyers, wrote and registered documents should be given credit for today's explosion in fractions.

This process allowed us to develop 1/5th fractional interests in Sunriver, OR in the late 1980s for example, and for the Deer Valley Club to begin sales in the early 90s.

If history is the prolog. What's the future?

Definition: Levels of Fractionals

Dick Ragatz, in his seven-year work on fractions, has defined the different levels of fractions based on price per square foot of the 'units' sold. Under his definitions, less than \$500 a square foot is a 'traditional fraction', \$500 to \$1000 is a 'mid-tier' and over \$1000 is a 'private residence club'.

We suggest there may be other indicators to judge where a fractional product falls within definitional terms.

It is our inclination to distinguish between two not three levels. We would group 'traditional' and mid-tier' together and then have, in the second category, 'private residence clubs'. So, just 'fractions' and 'private residence clubs'. And, from hereon out we'll call them that.

Why? Certainly, 'private residence clubs' are a class apart with very high selling prices and equally high service levels. Other fractions, positioned to meet specific market demands are just that - 'fractional' projects. They have had all the attributes of their higher priced cousins save one just not the flash and sometimes not the same owner reservation plan.

Reservation Plans

In the early days of fractions, the reservations plan [how the time is use] was a fixed, rotating calendar. So, if a quarter interest was sold the owner would have every fourth week to use, and each year the use weeks would advance one week. The same being true for a sixth or eighth week share. On larger fractions this plan also benefited the rental agent if the fractions were to have a dual use.

As developers gained more experience with fractional projects it became common for some fractions have a flexible reservation plan. For that matter some private residence clubs now have both fixed and flexible reservation plans. In fact, today, some of the most innovative reservation plans are of the combination type. So, as frequently happens, as buyer preferences are better understood, the way these condos and homes are used is merging together regardless of price points.

Is one use or reservation plan better than the other? Not necessarily, but human nature continues to demand

more flexibility in time use. Ragatz determined this by his research in 1982.

So, this assessment leads us to recommend two vs. three levels of fractions.

Tiers by destination

We might also look at the location in which fractions are developed. True destination resorts like Aspen, Stowe, Boca Raton, New York, etc. should have pricy and service intensive products that are in concert with the hotel options located there. It's expensive to go there....a \$105 dollar lunch for three in Vail last week for me, and no desserts! So, pricy locations = price real estate.

Regional resorts, by contrast, can be 'down home' and a fancy product may very well be out of place there. So, a fraction may be a better fit. Not all want overlays of service and expansive finishes and FF&E packages. One may want to let the kids roam and not be compulsive about breakage.

A project was built at Big Bear Lake outside of LA for the fractional buyer, but he finishes and FF&E were private residence clubs level. They lost sales because the buyer was 'afraid' to use the unit!

Demographics and Psychographics

Who buys the fraction? What are the motivations, the income levels, and do they have the same buying motivations as those who buy a private residence club?

The core element is discretionary income. Without it - no purchase. Discretionary income, naturally, comes in different amounts. A family income of \$50k may allow the purchase of a timeshare.

Income levels of, say, \$300k makes it easy to consider buying a private residence club share.

But, what about the in between levels? With all the competition for resources, (college tuition, primary-housing improvements, savings in general, and so forth) buying a vacation home more problematic.

So, one might say if not the whole vacation home why not just part of it? The obvious answer is that to some extent that is the answer. However, buying decisions are not based on just income levels and in this case disposable income levels.

The money to spend just opens the door so to speak. It's the physiological drivers that will allow a buying decision to be made.

Does the potential buyer see themselves as having 'earned' the right to a vacation home? How much does one value 'getting away' to the same place vs. a plethora of other family vacation choices? Are there kids at home, or are they empty nesters? Might the buyer be 'slumming' in their own minds by purchasing a fraction, or the eyes of those whose opinions they value? Or, conversely, if they own a timeshare is this just the next step in a series of smart steps to guarantee a rewarding, leisure lifestyle?

Many of the wealthy enjoy the idea of being thrifty and are thrifty; it shows they can save while keeping more. The middle-income folk have to save every day, every way, to meet their cash flow goals, so saving on a vacation home might not be what they want to do. It could be either the whole thing [really making it] or no ownership at all.

This is mitigated by the price of vacation homes. In the 'old days' one could buy a seasonal, vacation home for \$30k. Now, that may be \$300k or even \$500k - forget the destination resorts where it's millions.

Those with a more modest income level can revel in the ownership of a timeshare because of the luxury it affords. Some wealthy buy timeshares because it shows they can be value oriented and 'smart' to their peers. Plus, it's a heck of a product anyway.

Some middle-income folk might consider a fraction if it comes with a rental/investment opportunity. This allows them to be smart and more diversified with their investment strategy while still getting some

personal vacation use.

So, to develop a fractional project aimed at the middle income demographic and priced at that level may not be successful. One can say that it might take a finer marketing positioning for this type of offering that developing a very expensive private residence club.

Service Levels

What's expected of service? What price is one willing to pay for it? How expensive is it to provide?

Absolute luxury as provided by a few resort properties in the world is an expensive proposition assisted greatly if the resort is located off shore with low wages.

A resort can be built in a top location with excellent materials, well designed and constructed and that cost can be amortized over a number of years. The facility is one side of the two-edged luxury proposition. The other is service which means people; and people, unless in an underdeveloped area, are expensive.

As good a job as Four Seasons, Ritz, St. Regis and many independent hotel companies do in providing luxury they cannot be compared to their own foreign properties, where staffing costs are low. So, the staff to guest ratio is higher similar to cruise ships that are registered in foreign countries with foreign crews than in the U.S.

Can a homeowner's association offer real luxury as defined above? With the physical property, yes, especially if its sold on a fractional basis, so more money can be put into the physical property.

But, will the owners association pay the cost of staffing? More than likely, not. Owner associations are not known for their high rolling traditions.

In private residence clubs there are examples of service levels paid for and enjoyed; ski concierges and locker areas, heated boots, etc. Or, airport transportation via project-owned vans.

This is not the case with fractions where owners are more willing to do for them selves in order to pay, say, \$4500 per year in dues vs. \$12,000.

We make the case that no U.S. based private residence club can be a real five star property as defined in hotel ratings due to the personnel costs and the reality of HOA management policies.

So, coming down from that reality what service levels should a fractional project offer? The easy answer is: a service level commensurate with how service is defined by the buyer.

The buyer being middle income, for this example, say, a family income of \$175,000, may once in a while splurge on a luxury night out, they keep luxury pretty close to their vests as they have so many other family-based costs. So, the Hilton, Marriott, Westin service levels are expected and accepted. By the way, nothing wrong with that!

The same goes for dining at, say, Ruth's Chris or Outback, or \$4 drinks at Starbucks, etc.

It's an axiom for private residence clubs that the entry cost for the interest is not the deterrent, but it is the reservation plan and annual costs.

For the fractional owner the entry cost is important in addition to the ongoing costs, so that dictates, if the proper reserves are in place, that the service levels be defined to those that are necessary to run the resort but no extra frills.

Exchange

The draw of exchange is undeniably strong. If the fractional buyers see themselves as buying a vacation home vs. a travel product [timeshare] how does exchange fit in?

Intriguing, but not dominant in use. But, a very valid closing benefit. Exchange should be offered, but the developer should not expect to use large numbers of incoming exchangers as sales leads.

By having a vacation home to use throughout the year there is precious little time to exchange beyond personal use. By having a higher maintenance fee than a timeshare, there is less extra-disposal income to spend on getting to the exchange resort. So, we look for exchange, maybe, once every five years.

That usage pattern then dictates what the exchange company can charge for annual dues if exchange is not a frequently used option.

Marketing

What are the marketing messages to fractional customers? What do they want to know? How much of the story to tell?

The drivers are value, family, memories, and prestige.

1. Value for the money spent a wonderful vacation home larger and nicer than one might have chosen if they had decided to purchase a whole ownership home.
2. Family for the opportunity to provide quality vacations for the kids and/or grandkids to experience the alternatives to city life, and to engage in activities they would not have the chance to do in the city.
3. Memories for a lifetime.
4. Prestige for ownership of a real vacation home vs. a timeshare. Naturally, there can be some conflicting ideas working in this area as a timeshare can be seen as a great purchase and with a deed, just like a fraction, an investment in use and real estate especially in high demand areas like our projects in New York and San Francisco.

How do we reach them?

1. Internet marketing for sure. The challenge is to get the addresses, so linking with other businesses in the area or the major amenities is key. It's very tough to be a stand-alone project these days; one needs an anchor, or a number of smaller anchors on which to base the marketing program. Easier said than done, but.
2. Area real estate agents may have Internet addresses – yes. But beware the lack of attention and performance. “Times may be a-changing” with them, but history has recorded only a few instances where local brokers really jumped on a project and made sales.
3. Collaterals in the form of take-ones, fulfillment, ownership information, FAQs, floor plans, building renderings, financing sheets, etc.
4. Lead tracking software through Salesforce or others.
5. Site display area[s]

As opposed to many private residence club buyers, most of these buyers have not owned a vacation home before. Therefore the materials must be more basic to extol the benefits of vacation home ownership.

Sales

How do fractional customers want to be sold? How long should the sales cycle take? What to close on?

This is a mid-cycle sale. Timeshare is a short-cycle sale, and a wholly owned homes are a long-cycle sale. The reason why fractions are not a long-cycle sale is that in the extended time period they may lose interest and decide not to buy. The reason fractions are not a short-cycle sale is that the buyer is spending

more and making a psychological commitment to 'own' a vacation home, which will impact the life of the family.

Explaining 'why' a vacation home, and as a positive linking it to timeshare in concept, and then --as in every sale-- discovery is vital.

So goes discovery, so goes the sale. As we know the customer will tell the salesperson how and why the sale should go down.

Thereafter the key drivers will be the same as for private residence clubs: owner use and cost of ownership.

Both are delicate topics and the sale can be lost if either is not well handled. Nothing to hide at all, just the explanation has to fit the buyer's interest and retention abilities.

Consider this - if the customer is a family unit it is typical for one spouse to be more right brained and the other more left brained. It's the left-brainer that will need to be brought along more slowly as logic and detail are important. However, the left-brainer can get lost in the detail, so that's where the balance comes in.

Star Resorts knows that fractions are the hardest vacation product to be sold. More so than lots, homes, condos and timeshare. It's easily understood, then, that qualified sales executives are the one personnel category in greatest demand.

How long should the 'close' take? That really depends on the sales person and their skills. We know of sales folk who get buyers to sign the docs and leave the holding check, say, \$15k while on vacation. At the other end, which is the norm at this time, is the follow-up when home, and that process can take two weeks to three months.

Post Sale Management

Go to the Hilton, Sheraton, and Marriott model as cited above.

The annual dues as called for by the various state registrations should be in the \$4000 range including reserves. Attentive staffing is a must.

Single Family Homes as Fractions

There is interest with many developers or homeowners to sell single-family homes on a fractional basis. Some comments:

1. A one -off home will not work. Many reasons. Call is if you want more info.
2. A colony of homes will work assuming they fall into definable categories, so the use can be flexible through all the homes for better owner satisfaction.
3. Marketing can be a challenge as there is not critical mass.
4. Getting the right sales team will be a problem for the same reason.
5. A local property manager will probably do management, and that can cause quality control problems. Even though customers may say they want a no-frills experience, once they own they will want more services, and the local property manager may not be set up to handle them.

Conclusion

The Fractional Product has much value in the vacation real estate market. In a world where there are so many vacation choices, this is a viable option that fits the needs of many consumers and can be profitable for many developers. It does take a finer tuned operation to execute successfully than a private residence club – in many instances.

