Fractional Ownership Trends

1/7th of Heaven

By Patricia Kutza

The vision of spending precious vacation time lounging on a yacht in the Bermuda Islands, savoring après-ski cocktails at Sun Valley, chilling out in a pied-à-terre in the Big Apple, or getting a massage on the shores of your own Lake Tahoe getaway are the stuff of daydreams. But the sticker shock of wholly owning a yacht or prime-location property that you use only part of the year can quickly bring reality back into focus.

Millions of vacation lovers thought they opted for a slice of that luxe pie by investing in the timeshare model. But the hard-sell tactics and slipshod service of some timeshare management companies, plus the difficulties of timeshare owners not being able to use their week when and where they want, has tarnished timeshare's allure.

In response to owners' dissatisfaction, the vacation industry has devised a new concept, fractional ownerships, that are designed to alleviate timeshare shortcomings and meet the increasing demand by travelers for more upscale properties with better amenities. The main differences between various timeshare options and fractional ownership properties


Susan and Bill Bazinett relax at their Calistoga Lodge.

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— Jamie Schou, real estate broker

are prices, financing and fees (see table, page 42).

Fractionally Yours

Fractionals differentiate via personalized service, high-end products, more vacation time and much better scheduling. Look no further than the Sierra to see how fractional-ownership interests are targeting Lake Tahoe for the "all-season" sports niche. Luxury-based lodging under construction at Northstar-at-Tahoe and Kirkwood and restoration projects at Squaw Valley are representative of this push into a real estate market that resembles much more a mix of different types of property investments than a homogenous property landscape.

In 2003, Novato residents Gage and Sharlene Johnson snagged a fractional property on the North Shore at the Lake Tahoe-based private residence club Tonopalo, one of a series of "Storied Places" that comprises developer Intrawest's North American luxury portfolio.

tonopalo.com

Initially, says Gage Johnson, "The concept of shared ownership didn't set well with me. I was concerned that we wouldn't be able to visit our home on our preferred schedule."

Tonopalo's rotation access plan allayed his fears. Since each Tonopalo residence has no more than seven owners, every seventh year the Johnsons get first pick for their weeks in the high-priority seasons, summer and fall, for a total of four weeks. Each owner is also entitled to one week of access in the winter and the spring. "It's a very fair system that has so far worked well for us," he says.

Last year they used their reciprocal privileges and booked their winter time at another Storied Places property, At Nature's Door, in Whistler, B.C.

The Johnsons' wish for maintenance-free living is typical of most prospective buyers, says Tonopalo real estate broker Jamie Schou, and amenities are important, too. "More than any other demographic, such as retirees or singles, we are seeing families flock to this concept. They want to arrive at their vacation home to do nothing but relax.

"Along with the pool, Jacuzzi and 24-hour concierge service, we offer about 270 square feet of prime Tahoe beach access," Schou says, "enough for owners to feel that they are living the Lake Tahoe lifestyle."

Susan and Bill Bazinett didn't know about the possibilities of fractional ownership when they visited and subsequently fell in love with The Lodges at Calistoga Ranch during a stay at the ranch's hotel property last year. With its wine-region locale and wine-centric tastings, tours, picnics and concerts, the Lodges at Calistoga Ranch represents one of the theme niches starting to differentiate the fractional-ownership sector.

calistogaranchliving.com

"We had been looking for a second property when we celebrated my birthday at the resort," says Susan Bazinett, broker and owner of the Danville-based Blackhawk Real Estate Co.

Johnson property fast facts:

- **Tonopalo fractional properties range from $379,000 to $925,000 for one-seventh fractional shares. The Johnsons bought their 3-bedroom, 2-bath, 2,400-sq.-ft. home for $365,000 in 2003.**
- **Their annual maintenance cost (billed quarterly) is approximately $11,000 (covering all utilities, garbage, cable hookup and internet connection but not property tax).**
- **The Johnsons received a 'fee simple' deed (tenants-in-common).**

The Complicated Vacation Investment Market

The *Prosper* comparison illustrated below assumes that single-owned properties are priced at $2 million, the typical market value of most private-residence club properties. Tax implications will vary, subject to individual circumstances.

Type of Property	Private home, wholly owned	Timeshare	Private Residence Club	Condo-Hotel
Location	City or resort	City or resort	Typically in beach, desert or ski area	Can be in beach, desert or ski area or city environment
Investment	Owner pays full cost of property	Owner pays initial fee	Owner pays fraction (1/7th to 1/13th) for access to a residence	Whole ownership is most common. Fractional ownership is emerging option.
Annual Fees	May pay association costs within private community	Annual maintenance fees	Operating expenses to cover maintenance, staffing and utility costs for grounds and amenities	Association fees
Amenities	Limited to personal property	Properties typically in the 2- or 3-star range	4- and 5-star quality with concierge services and privileges at nearby golf courses and fitness facilities	Access to hotel services such as fitness centers; concierge, restaurants
Access	Unlimited; can rent and redecorate at will	Average is one week per year; can't sublet or redecorate	At least six weeks per year. May offer tiered access. No rentals or redecorating allowed	Unlimited access with whole ownership. Rentals encouraged with hotel rental program; cannot redecorate at will
Reciprocal Privileges	N/A	With properties in timeshare portfolio	With other properties in club portfolio or via company partnerships with other clubs	None
Equity	Property deed	Can be property (deed) or right-to-use (no equity)	Property deed or limited liability corporation (LLC) certificate of ownership	Property deed

Tai Quan and family took their fractionally owned luxury RV to Bryce Canyon this summer.

The Bazinetts paid $425,000 for a one-tenth share in a lodge and annually pay about $12,000 for homeowner association fees. The ranch has a formal scheduling process, but unlike many other private-residence clubs, it offers its fractional owners unlimited access, subject only to availability. "With the superior level of service and amenities, we feel we are getting a one-of-a-kind experience" she says. "We are both very busy professionals and want the benefits of a second home without the maintenance headaches."

The Napa-based Calistoga Ranch has completed the first five of 27 lodges that will eventually constitute the fractional-ownership section of its 157-acre property. The lodges are part of the Auberge Resort, and the Bazinetts therefore also have access rights at other Auberge Resort Properties — Esperanza Resort in Cabo San Lucas, Auberge du Soleil in Napa Valley and The Lodge at Corde Valle near San Jose.

Rent and Recoup

After years of renting at Tahoe, many luxury-seeking vacationers can fall in love with the amenities offered by private-residence clubs such as Calistoga Ranch and Tonopalo. But the fractional-share investment and annual operating costs are not in their price range, unless they can recoup some of the cost by renting their unused time.

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>
> — Joshua Potvin, vice president of sales and marketing, Luxury Fractional Guide

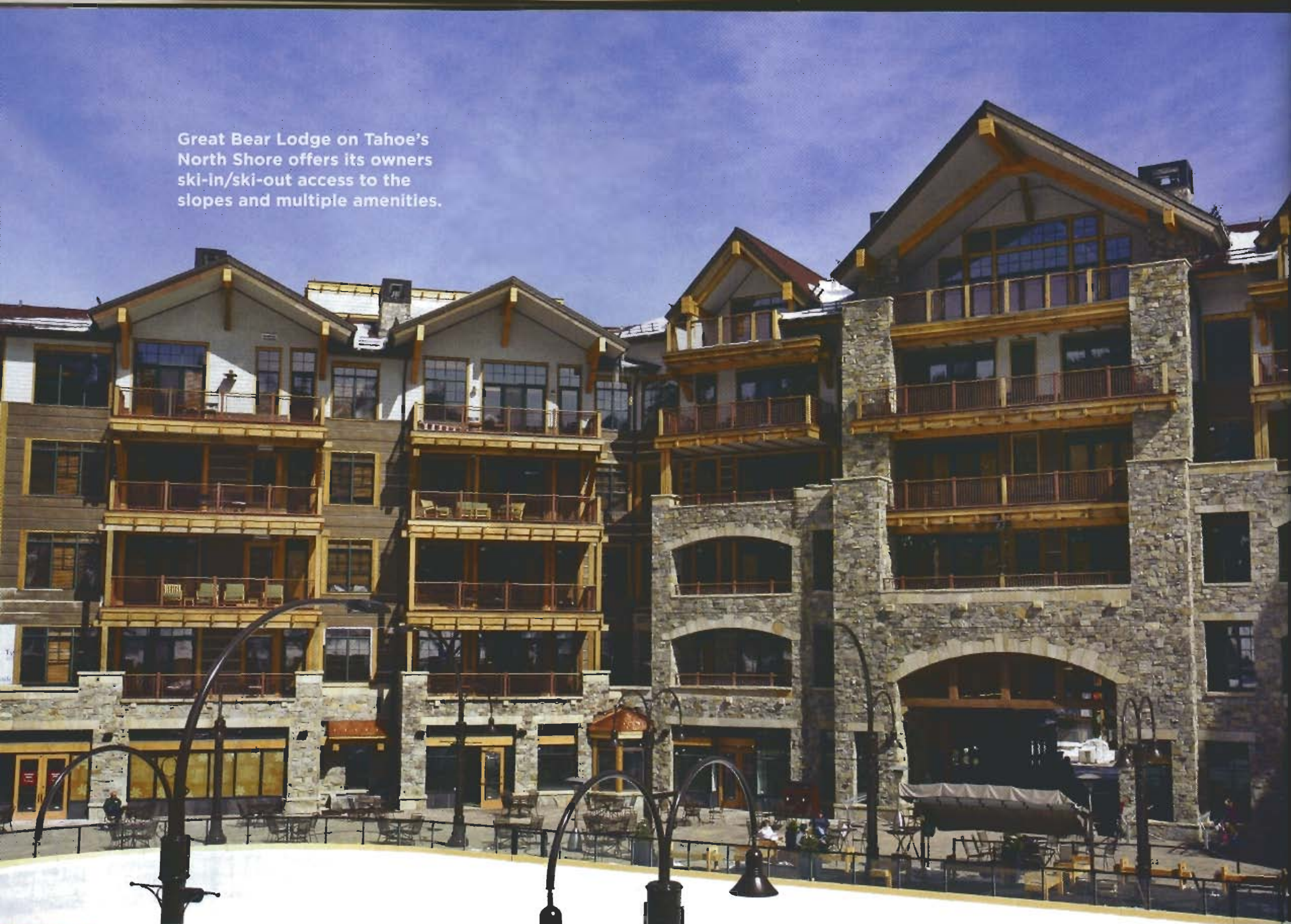
Unfortunately, renting unused time is not an option at most private-residence clubs. What about condo-hotel units? Condo-hotel units are sold as individual rooms or suites located within a major hotel or resort complex. Condo-hotel promoters emphasize how owners can leverage their unused time by using the hotel rental program to obtain rental income and thereby offset monthly homeowner fees and yearly operating assessments. The hotel has an incentive to rent owners' unused time, since it takes a portion of the rental income.

Condo-hotel units and private-residence clubs, à la the Club Med model, are transforming a Tahoe region once dominated by hotels, motels and single-owner rental properties.

However, both buyers and sellers are going through adjustment pains with these new options. Introducing the condo-hotel concept into an established resort has created a unique marketing challenge, says Doug Phillips, executive director of sales and marketing for Resort at Squaw Creek at the base of Squaw Valley USA. The resort recently completed a $53 million renovation, which included converting the property's 405 guest rooms into privately owned luxury residential units.

squawcreek.com

With such a diverse selection of vacation property options, property owners who are very clear about their goals, namely, where they want to vacation and how long they can stay, stand the best chance of profiting from their investment choices, points out Joshua



Great Bear Lodge on Tahoe's North Shore offers its owners ski-in/ski-out access to the slopes and multiple amenities.

Potvin, vice president of sales and marketing for the Luxury Fractional Guide, an online one-stop resource for fractional opportunities. "Before purchasing, buyers of fractionally owned property should understand completely how the private-residence clubs' usage program operates so they can determine if it fits their lifestyle and schedule," he says.

luxuryfractionalguide.com

Road Trip Panache

Some folks cross over to fractionals after trying traditional timeshare. Others, such as Silicon Valley engineering executive Tai Quan, are trying it without any prior timeshare experience. Wanting to spend time with their two college-bound children, Quan and his wife Theresa fell in love with the idea of vacationing together in a luxury motor coach. Visits to RV lots were a rude awakening. Factoring in the actual leisure time they could afford to spend using the RV, the $500,000 price tag seemed prohibitive. "At 40 feet long, we also wondered where we could even park it," Quan says.

They chose instead to buy a fractional interest in a Monaco Diplomat 40 PDQ, offered by CoachShare Inc. The Quans paid approximately $36,000 for a one-eighth share, entitling them to use it five weeks a year for three years. They also pay monthly operating fees of $290 to cover recurring costs such as storage, insurance, maintenance and roadside assistance.

At the end of the term, the Quans can sell back their share to CoachShare or choose to renew for another three-year term. Since buying their share in December 2005, the Quans have made several trips in their Monaco. "I don't think we would have enjoyed this level of service had we bought it outright," Quan says. "Before we purchased the RV, we averaged about four $5,000 family vacations a year. Considering those costs, and comparing the fun traveling together in our coach, we think we have made the right choice."

coachshare.com

Finding, Funding a Fractional

Theoretically, most types of real and personal property are great candidates for fractional ownership. The catch is finding others wanting the same property and wading through the complexities involved with making it legal.

It's a ripe area for companies such as San Diego-based Breeze Easy Inc., which is positioning itself as a prime matchmaker for vacationers wanting to share homes, yachts, aircraft and recreational vehicles. Breeze Easy, says its president, William Blozan, can help potential partners find the property they want at the price point they can afford coupled with the use they need, as well as carry through with the logistics needed to create the partnership.

breezeeasy.com

But investors should note, explains Luxury Fractional Guide's Potvin, that

Do Timeshares Work With 1031 Exchange?

Timeshares may qualify under IRC Section 1031; it depends upon whether they are classified as personal property or real property. The distinction is important, because in a 1031 exchange, real estate can only be exchanged for real estate, not for personal property.

Before arranging to purchase a timeshare interest with exchange equity, review your timeshare documentation. If you will receive legal title to a portion of the property you will use at certain points, and there is a grant deed evidencing your interest, then the timeshare interest is most likely structured as a real estate interest. It is acceptable to exchange into real estate with many other co-owners as long as each person actually owns an undivided, fractional, tenancy-in-common interest in the property.

If a grant deed will not be recorded in your name, and the contract only gives you a right to use (not own) a particular unit for a specified period of time, then the timeshare is most likely structured as personal property, and 1031 exchange equity cannot be used to purchase it.

Even if your timeshare qualifies as real estate, you should purchase the timeshare with the intent to hold it for investment. In 1993, the U.S. Tax Court held that a two-week timeshare received by a taxpayer as replacement property in an exchange did not qualify for 1031 tax deferral because the taxpayer and his family used it for vacation purposes, and the taxpayer could not provide evidence that he ever attempted to rent the units at fair market value (see "Your Money," page 52).

— Nicole DeSantis

while fractional properties may operate similarly to conventional properties (meaning the properties can be bought and sold using the Multiple Listing Service and bequeathed), traditional mortgage-lending institutions have not yet warmed to them.

"Banks are shy to lend because they don't know how to get rid of a fractional on the books should they need to foreclose," says Potvin. But lenders are slowly getting onboard, says Breeze Easy's Blozan. "Such consumer mortgage lenders as First Fractional Funding and Ward Financial Co. are emerging to meet the unique needs of buyers and developers of fractional-share properties."

wardfinancial.com

bankofkc.com

Michael Burns, chairman of Crescendo, a luxury real estate investment group with corporate headquarters in Roseville, says that securing financing is probably not a big hurdle for most buyers investing in private-residence clubs.

"Prospective owners may already have vacation property and are simply looking to diversify by location or type of property," he notes. "They use their existing relationships with banks, which in most cases are already based on a solid portfolio of financial investments. So they may take out a personal loan or pay cash. For example, a one-seventh fractional share of a $2.5 million home will cost around $350,000, very close to what they would pay for a down payment if they bought it whole."

Creative Relationships

From Crescendo's standpoint, it's all about creative relationships. Because it's a fully compliant, Regulation D securities offering, Crescendo cannot advertise for investors. It plans to raise its profile by partnering with money-management firms that already have strong relationships with clientele attracted to its growing portfolio of premium residences around the world.

"We currently have more than 50 investors who can enjoy seven luxurious residences located in New York City, Arizona, Idaho, California and Mexico," says Burns. In the Village at Northstar, located outside Truckee, a 20-minute drive to Tahoe's North Shore, fractional-property owners can stay at the Great Bear Lodge, a 2,400-sq.-ft., 3-bedroom, 3.5-bath, ski-in/ski-out home that features a private elevator, multiple balconies and amenities linked to its partnership with the Tahoe Mountain Club. It includes golf course privileges at the Old Greenwood Golf Course, a new golf community being built in Truckee.

crescendoresidences.com

"We are the best bet for combining lifestyle and investment," says Crescendo CIO Chris Soderquist. "When buyers invest in Crescendo, it's similar to investing in a mutual fund, because they buy into our entire home inventory, not just one particular property. They reap the benefits of diversification while enjoying equity ownership."

Crescendo investors pay $295,000, giving them 20,000 shares in the company. They also pay operating expenses ranging from $15,000 to $28,000 annually and can choose from three usage plans.

Looking ahead, Soderquist envisions an extensive globally diversified portfolio of homes. "By 2009," he projects, "we want to own 38 homes located in the United States, Europe and the Caribbean; 50 percent of them will be beachfront property, 30 percent mountain-based and the rest located in cities and other environments. So, 266 investors will hold a total of $100 million worth of real estate."

Just like the vacationers themselves, fractional ownerships of vacation homes come in all shapes and sizes. But one thing is clear: Packing a bag and heading out on a whim is for amateurs. The savviest among us are planning fun per quarter and expecting a high rate of return.