

A Guide for Vacation Home Owners in Crisis—What Not to Do/Expect If Your Home Is No Longer Affordable ©

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The year 2009 will be a tough one for owners of vacation rental homes. Below, I address common questions, pitfalls, and options for dealing with a vacation home that is no longer affordable.

The Problem – Short and Simple. The Internet, economy and financial markets have conspired to decrease the value of vacation rental homes as investments and to increase their carrying costs. Many homeowners can no longer comfortably afford the investment.

Your Options. Your major investment options are not happy ones:

- Bite the bullet, dig deeper into your pocket to cover monthly expenses, and gamble that you will someday recoup these monthly expenses; or
- Sell your home, perhaps for a loss, so as to stop the monthly cash drain.

Educate Yourself Before Acting. Unfortunately, there are few real solutions but a swarm of businesses who urge remedies that may only increase your problems.

- No one can predict if/when vacation home investments will improve;
- Calculate how long you can financially support your rental home at current rents;
- Be prepared to cut your losses if you cannot hang in there at existing rents;
- Be cautious about “solutions” that could add expense or stress to your life;
- Don’t change managers or try rent-by-owner without finishing this article.

The Problem Has Six Facets—None Controllable by Rental Managers.

1. More renters are unemployed, underemployed or in fear of this, which will translate to fewer bookings and shorter stays for vacation rental homes;
2. Average daily rent per booking will drop because the Internet enables renters to bargain down rents (because industry occupancy rates historically average 35%);
3. At the very moment rents are declining, home ownership costs are increasing (*e.g.*, flood insurance and heat)—these come directly out of homeowner pockets;
4. Homeowners pockets are emptier because costs of living are up (health care, fuel), forcing homeowners to give up life-style benefits and feel financial pain;
5. Homeowners have less incentive to endure financial pain because a housing bubble popped, reducing or eliminating their home equity;
6. A mortgage crisis has made it difficult to sell vacation homes, even at a loss.

Investment Incentives Revolve Around Appreciation, Not Rentals. Vacation homes are real estate investments—not investment in lodging. Vacation rentals almost never generate a profit, and most homeowners don’t expect them to.

The Role of Rentals in a Vacation Home Investment. Investors put up a down payment, doll out money to pay the monthly mortgage and expenses, and realize a return on investment if/when the home can be sold at an appreciated value. The role of rentals is to help renters invest in a more expensive home (one with more potential appreciation).

When Rents Rise or Fall they Alter Which Investors Can Own Vacation Homes. Vacation home investment is a harsh endeavor. Rents periodically rise and fall. When they fall (the risk investors take), financially stretched homeowners are forced to sell to investors who can better afford the carrying costs.

When Must I Sell at a Loss? If you can wait until homes start appreciating again, you might be able to sell without loss to a buyer who can better afford high carrying costs. Be sure you can afford to lose any additional money you put into your home. If you can't justify putting more money into the home and your home appears overvalued or financing is unavailable, you may have to sell at a loss to attract a buyer.

What about Self-Management (Rent-by-Owner)?

There are self-styled experts who sell books or web site services by saying you can save money if you bypass a rental manager and rent your home yourself. The primary impetus behind this is the growing number of listing sites that help home owners find renters. I can say this: self-management will not work for the vast majority of home owners.

- **Ignore the Hype.** Despite the promotional hype of investor-financed “rent-by-owner” vacation rental home listing sites, you will not “save” money by self-management so much as “earn” it by doing some of America’s most dirty work.
- **The Real Challenge.** The greatest difficulty in vacation rentals is not advertising and booking your home but in fixing it, cleaning it, and taking care of the screaming guests.
- **What Managers Do.** Managers are on-site experts who set up systems that anticipate problems, forestall them and handle them when they occur.
- **Problems Arise Constantly.** Managers’ work-order statistics demonstrate that major maintenance problems occur more frequently than bookings;
- **Service Is Hard To Get.** A homeowner can’t get a busy air conditioner repairman to respond as quickly as a rental manager who gives him hundreds of work orders;
- **Stress.** Renters are difficult and stressful to deal with: they negotiate rents and demand money back when even little things go wrong;
- **Reliable Workers.** What are the odds that you will find those rare local cleaners and handymen who deliver exceptional service and never get high, drunk, sick, divorced, fed up, or lured away by a higher paying homeowner? Managers have back-up cleaners and are on-site to monitor and compensate for people problems;
- **Good Rent-By-Owners Become Managers.** Self-management is so stressful and difficult that homeowners who do it well are often asked by neighbors to manage their homes, launching new careers as vacation rental managers.
- **Other Problems.** Home owners who self-manage often get investigated if they fail to collect/pay occupancy tax, they lose renters because they can’t take credit cards, and they find their lives disrupted and stressed by the endeavor.

Should I Move My Home to a Better Rental Manager?

Perhaps, if you have a bad manager. (but you would probably have known this before the economy went south.) If your manager isn't clearly bad, consider this:

- Every resort area has a hierarchy of management companies where the "top" tier offer more services and, often, get more rentals, but ...
- There are good reasons why only 5-10% of rental homes leave rental programs each year (with much of that involving home sales);
- Commonly, rental managers are built around a distinct type or mix of inventory that prospers in that rental program;
- A fifteen year-old, smaller home may not rent well in a program known for large, high end homes that charges higher fees;
- Each rental company tends to be patronized by a pool of renters that is expecting a certain type of home, and costs/benefits tend to be balanced;
- Managers that provide more service tend to charge more and attract renters who are willing to pay more;
- Switching rental managers won't improve a homeowner's cash flow if the additional rentals arise from more aggressive rent discounts;
- Chances are good that, if you do switch, you won't have access to the statistics you would need to know if you made the right move;

Should I Move My Home to A Manager Who Does Less But Charges Less?

You might consider this if you are in a rental program whose services are geared to higher caliber homes, and you are sure you and your home's renters are "over served" and paying for services that aren't wanted and don't generate more rental income;

- There are a growing number of managers who do not have a public office, full-time reservations staff, or local service facilities;
- But programs with high-end inventory may generate "overflow" renters for less elaborate homes when renters' first choice home is unavailable;
- Be aware that you may not know what your manager brings until you leave;
- Also consider whether the resale value of your home will be influenced by the quality of maintenance provided by your rental manager.

How Do I Deal With Discounting?

This is tricky. Hotel studies have shown that discounting does not improve the bottom line, and rental managers have been reluctant to discount except as necessary. Today, however, prices float with supply and demand. So it is important that you give your manager authority to change the rent without calling you first, or you will lose rents to homes that do delegate pricing to the manager (who has an interest in getting the highest possible rent). This change is attributable to the Internet:

- It has allowed consumers to see and exploit the fact that vacation rental homes are vacant approximately 65% of the year (giving consumers bargaining power);
- It has generated a host of rent-by-owner sites where homeowners—inexperienced in pricing or panicked—may flood the market with aggressive discounts;
- The concept of "discounting" is becoming outdated, because pricing is today "dynamic," changing with supply and demand (there is no right price to discount).

- Many homeowners in rental programs are reducing rents in a desperate bid to get more rentals, flooding managers' "specials" pages and forcing prices down;
- The Internet allows renters to quickly compare prices, and to find "specials."
- So the only prices that count are those being offered on the day a renters "looks and books" -- rent-by-owner listing sites and managers' specials pages are key;

Should I Expect My Rental Manager to Share in the Discounts?

Homeowners often split the rents with their managers (*e.g.*, pay a 3-50% commission). They may also pay certain expenses, such as spring cleaning, from their share of the commission split, and allow the manager to take certain "add-on" fees (*e.g.*, reservation fees) off the top before the commission split. Many ask whether their managers should shoulder a greater share of the discounts in this slow market. The answer is "no."

- If your manager splits the rents (commissions) he already shares in discounting;
- It won't be in your interests to push rental managers to take a bigger share;
- Most don't have the resources to contribute without reducing the service levels and promotion that is needed to retain and attract renters in this down market;
- A down market is causing your losses, not your manager's failure to do what he is supposed to do, and market cycles are a normal investment risk;
- There is little basis for asking manager to share your losses because you as an investor do not share profits when you sell your home;

Is My Manager Ripping Me off with Add-On Fees?

Every homeowner and renter dislikes add-on fees, and our credit card accounts are perfect examples. But don't put too much energy into this.

- Fees, while maddening, are the way the competitive market place has forced managers to structure fee increases over the years.
- Unfortunately, commission rates are no longer adequate to handle the cost increases associated with Internet search words, web site on-line booking, etc.
- Homeowners left managers who tried to increase fees, but proved willing to pay add-on fees that achieved the same effect--marketing psychology rules here;
- These fees, for the vast majority of rental managers, are not ripping you off--they subsidize the money you pay for maintenance, housekeeping and the money managers can take from their commission splits for marketing.
- The proof of this is in the fact that we see no excessive profits in the vacation rental industry, which operates efficiently with small margins and little waste.

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George Volsky is one of the vacation rental industry's premier analysts and consultants. He has studied the impact of vacation rentals on local and state economies, written decision support software to analyze market trends, valued management companies and served as the industry expert for the 2009 PhoCusWright study of the vacation rentals industry.