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FRACTIONAL OWNERSHIP: GETTING A PIECE OF THE PIE



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More Than a Fraction of the

American Dream: Vacation Home Ownership

For many of us, owning a vacation home is part of the “American Dream.” Unfortunately, the rising cost of real estate has made many think that the ski lodge or beachside retreat they’ve always wanted is unattainable. Even when some are actually able to purchase second homes, they are quick to express frustration at not being able to spend more time there. It seems to them like the high cost of owning a vacation home (mortgage, upkeep, insurance and taxes) far outweighs the benefits of using the property for just a few weeks a year.

So, for a rapidly increasing number of Americans, including those who already own at least one vacation home, fractional ownership has given them something that they once thought was impossible – a vacation haven that they can enjoy as much or as little as they want, for a fraction of the cost (pun intended). Fractional owners get beautiful, high-quality vacation houses or condos, in fantastic locations, with great services and amenities for 10% or 15% of what they would have to pay to buy the property on their own. The costs of

buying and running the property is shared by a number of people and, instead of sitting idle most of the time, the homes are nearly always being used.

A Piece of Fractional Ownership History

Fractional owners form one of the fastest-growing segments of the vacation home market. New sales totaled \$1.5 billion in 2005, up 42 percent for the year. The industry began in Utah little more than 10 years ago when Steve Dering, of DCP International, started the first fractional-ownership community in Park City. Many of the very expensive lodge-type homes there were under-utilized and he figured owners were spending a lot of money for just three or four weeks of use.

They’re Not Timeshares!

From a strictly legal standpoint, the term “timeshare” refers to any arrangement under which a group of people co-own a property based on time; but from a practical standpoint, there are significant differences between fractional and timeshare ownership. For one thing, time shares are merely contracts specifying a right to use a property on certain weeks. Fractional owners usually get an actual, owned, deeded interest, which can be sold, left in a will or put in a trust, practically anything that can be done with any deeded property. In sum then, the meaningful difference between most timeshares and fractional ownership arrangements is the extent of ownership and control given to the users of the property.

However, generalizations about the distinction between timeshares and fractionals can be misleading. It is important for buyers and those advising them, not to be misled by the way something is named or advertised, or even by

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whether it's deeded or not. Because, contrary to popular misconception, having deeded ownership of a co-owned property does not automatically determine (by mere virtue of having a deed) property owners' control over how the property will be managed, what ownership costs will be in the future, or whether the property will increase in value over time.

Who Should Buy?

Given their relatively short history, data on whether fractionals make money is limited. However, there has been at least one example of a property that has been a good investment. At the Deer Valley Club in Park City, shares that cost \$130,000 about 10 years ago sell for about \$655,000 today, according to Dering. And since fractionals are currently located in sought after locales like Cabo San Lucas, St. Thomas, and expanding to cities such as New York and San Francisco, the probability that these kind of properties will increase in value seems more likely than not, especially those properties geared towards the in-demand luxury market, like the Front Four in Stowe, VT.

The Front Four is a very upscale fractional offering added services and amenities to owners such as a Platinum Membership in the Stowe Mountain Club, an exclusive club with private dining and lounges, ski passes, unlimited golf, access to a world class spa and wellness facility and then some. "The Front Four Private Residence Club in Stowe is comprised of 34 two-, three- and four-bedroom suites. The owners have their own private concierge that handles all pre-arrival needs as well as anything to make their stay more enjoyable and stress-free." Said Rick Sokoloff, a Sales Executive for The Front Four. "In addition, every day a continental breakfast is provided, there is an owner's afternoon social and a light cleaning of the suites. It really is luxury living with the benefit of ownership without the hassle."

But the increase in the real property value must be weighed against some of the costs unique to fractionally owned properties, like management fees, the costs of repairs

and, maintenance/cleaning costs. In addition, many fractional interests are priced at a premium, i.e., each interest when added together usually equals more than the price of the whole property. So to have a more accurate sense of the investment value of fractionally owned property, all costs must be weighed against any projected increase in the resale value.

Professionals advising prospective buyers of fractional interests in vacation property should be careful to state that typically they are primarily for people who could afford a vacation home but don't have the time to use it fully. "What I find is that many of the people that choose to purchase in the Front Four have the wherewithal to purchase our \$2 to \$3 million condominiums," states Mr. Sokoloff, "They just can't justify the expense when they are basically getting the same thing at 1/8th the price." They are not necessarily good for those seeking to re-sell and make a killing, although if real estate prices rise vigorously, all property owners (regardless of ownership type) will benefit.

As far as resale, prospective co-owners must read their fractional ownership documents carefully to make sure that the terms of purchase allow them to sell to others outside the group. Their ability to sell may be subject to restrictions like, rights of first refusal and/or rejection for existing co-owners. These restrictions protect the group from incompatible or unqualified buyers but are not an outright prohibition on resale. Restrictions prohibiting individual resale outright or requiring unanimous consent for them may mean that there is no way for a co-owner to exit the group without selling her interest to another co-owner and no other co-owner may be interested in purchasing an additional share.

Legal Documents Owners Should Know Something About
Fractional ownership documents fall into two general categories: (i) those that are recorded in the chain of title to the co-owned property and thereby become binding on each subsequent owner even without that owner's signature, and (ii) those that are unrecorded and bind only those that sign them.

Most fractional arrangements involve a combination of recorded documents like deeds, and unrecorded documents like management agreements, but one should not make generalizations about the kinds of documents or their names since each seller will undoubtedly use their own. Notwithstanding the fact that there are many flavors of documents, it may be useful to become familiar with some common names being used for fractional property documents like, “Declarations”, “User Agreement”, “Agreement to Purchase Real Property”, and “Bylaws.” Since there is no uniform requirement that all documents with a particular name contain the same terms and conditions, it is key that buyers review all documents carefully to make certain that they are getting what they bargained for.

What About Taxes?

In general, the tax treatment of vacation homes depends on how often the property is used for personal use and how often it is used as a rental. When vacation property is co-owned I.R.S. regulations seem to contemplate that usage of all the co-owners (and their relatives, non-paying friends, and swappers) should be added together to determine the total number of personal use days and any other days that the property was used by someone else are considered rental days. Tax deductions for mortgage interest and property tax will depend on whether the co-owners seeking to take those deductions, qualify as “pure second home” owners by the I.R.S. As far as state law, Massachusetts seniors and veterans who qualify for certain exemptions from property tax may still qualify as fractional owners.

Tax law and other areas of law that affect fractional property purchasing like real property law, securities law and corporate law, can be very complex; therefore, fractional buyers (even those who have previously bought properties and therefore feel like they are comfortable with what it means to buy property) should seek the assistance of professionals, like

lawyers, real estate agents and/or accountants when purchasing their interests.

Other Legal Restrictions to Be Aware Of

Several types of legal restrictions can apply to fractional vacation home sharing arrangements. These can be grouped in four general categories: (i) state real estate laws and regulations, (ii) local real estate laws and regulations, (iii) private deed restrictions, and (iv) federal and state securities laws. Laws in these categories vary from state to state and from municipality to municipality and, often times apply to real estate transactions regardless of what the individual transaction documents state. So it is important for buyers to check with professionals (like those mentioned above) in their home state, for advice on how these laws may affect any fractional ownership purchase, especially since these laws can often have registration and compliance requirements. Plus, where fractional property is located abroad, prospective co-owners and even their local attorney are less likely to be familiar with foreign laws. In foreign matters it is essential to involve both a U.S. attorney and a reputable foreign lawyer or law firm.

A Short Checklist for Prospective Purchasers:

Just a Fraction of All the Considerations

Keeping in mind that purchasing any real estate is, in general, a serious and complex matter for which buyers should engage the help of trained professionals, the following is a 5-item checklist that buyers could use, at least as a preliminary matter, when deciding whether fractional vacation home ownership is for them:

- Why am I considering buying a fractional interest, is it for re-sale do I just want somewhere to regularly vacation with my family or friends?
- What is my real cost, considering: (a) how often I’ll use the property, (b) any fees, (c) property taxes, (d) membership dues, (e) cleaning and repair costs and,

(f) any other costs as determined by my legal documents or by other laws?

- As a co-owner what kind of control will I have over how the property is managed?
- What kind of tax treatment can I expect from buying, owning, reselling or transferring the property interest in any way?
- What kinds of restrictions are there on renting or re-selling the property?

Getting a Second Piece of Pie

For anyone considering buying their first or their second vacation home, purchasing it as a fractional interest could offer them all the benefits of ownership with the added incentive of sharing burdens like maintenance and property tax. The American dream today is about more than mere ownership of one's residence. Buying the home where one lives is like getting one piece of the American pie, while buying a piece of vacation property is like getting a second piece of the American pie. Fractional ownership is a way to get that second piece of pie!