

## **Fractional Ownership: A Beginner's Guide**

'Fractional Ownership' describes shared ownership, which allocates usage rights based on time. Only one owner will be allowed to use the unit at a time. Co owners may have ownership rights to all, some, or only one unit. Usage rights and cost obligations may or may not correspond to ownership rights.

Most definitions of the term 'timeshare' include arrangements by which people share use of a property, based on time, regardless of whether they own the property or whether a management company/ developer manages the property.

"Time share' and "Fractional Ownership" differ greatly. It is not a question of devolving title. Many 'time share' properties involve direct, titled ownership and many 'Fractionals' don't.

The main differences are:-

- 1) The extent to which participants' rights and responsibilities are limited to a particular unit or units.
- 2) Each owner's degree of ownership/ control. [Ownership evidenced by deed, doesn't give a person any particular level of control over how the unit will be managed.]

The document governing the shared unit, not the name of the "arrangement" is decisive.

Ask yourself:-

- 1) Is the agreement flexible?
- 2) Can it be changed and is each person protected from changes that will reduce the usefulness of the property?
- 3) Is the usage system fair and can someone "manipulate" it?
- 4) Can each owner control which unit they will use on a particular visit?
- 5) Can they always return to the same unit? If not, what changes will there be in size and amenities?
- 6) Are costs and responsibilities limited to the unit[s] they will use, or do they extend to other units that others will use. Will each person's costs / responsibilities be proportional to usage rights?
- 7) Can they control management fees and management /maintenance?
- 8) Can owners rent out the property and control the rent?
- 9) Can an owner holiday elsewhere, and can they get the desired location and dates?
- 10) Do restrictions apply on disposal?
- 11) Is finance available?

Many people dream of owning a holiday home, but either can't afford the type they want or couldn't justify the small annual usage period. Fractional ownership provides a solution by reducing the costs/ annual expenses, sharing maintenance problems and depreciation. By dividing costs/ risks, owners surrender usage rights associated with full ownership; often an acceptable sacrifice and a huge cost saving.

"Fractionals" free up capital to invest elsewhere. They provide an alternative to a full sale in a depression. "Fractionals" are cheaper on a new development, providing an extra choice and developers have an alternative in a recession. A cheaper option also increases the visibility of the site and sales of "whole ownership".

Local legal restrictions may impact on fractional arrangements, even where friends purchase. National law determines the structure, how and where the interest will be marketed and who can buy. Regulatory approval means costs and delay and in some cases approval may be denied based on the location of the property.

Restrictions are imposed because, shares are sold as a promise that one owner can use the unit at a particular time. They may apply where rental income is pooled, management responsibilities are delegated or the purpose is primarily for investment.

The usage calendar depends on location, size, seasonality, number of scheduled visits and travel time. A complicated system will fail and increase costs. In most schemes, owners are assigned exclusive use for a specified period each year. The period can be fixed, variable or both.

Price depends on time bought, type of unit and use. Occupancy is calculated on a yearly calendar. Not all calendars work fairly!

The management tasks of fractional ownership properties are divided into time allocation, accounting, cleaning and repairs. Co owners or contractors can perform these. Operating expenses are usually divided in proportion to ownership. To avoid "financial" disputes, collect contributions based on the future budgets, not 'ad hoc'. Anticipated expenses should include fund reserves for long term recurring expenses. Use a payment schedule. This makes tracking payments easier.

Cleanliness is paramount. Co owners prefer clean units and cleanliness is essential for renting. Employ a cleaner!

Repairs are important as no one person is responsible for repairs and small problems can become large ones. The management must inspect regularly.

Developers determine owners' powers, how decisions will be made and how to devolve eventual control. They establish certain mandatory duties, unless all owners otherwise agree, including paying the recurring expenses and maintenance. Decisions can be taken by board management or by majority vote.

Written fractional agreements are a MUST, detailing reciprocally binding rights, obligations and enforceability. The principal advantage of a written document is the reduced risk of disputes. The principal disadvantage of written documents is that they are more difficult to modify.

What happens if co owners default? Whilst a potential risk, it is important to keep the problem in perspective. Co owners are most concerned about non payment, abuse of the shared property, failure to clean and unauthorised/ improper usage. The agreement must allow the group the choice to deal with defaults quickly. Provide for the service of a notice on the defaulting party and the right to reply. Give time to remedy and then act if not remedied quickly. Use ADR.

The ultimate sanction is sale. Sale proceeds are applied to pay arrears, costs, legal fees and penalties. Any remainder goes to the defaulting owner.

Establish a “default reserve fund” to pay overdue payments. This is not intended to be a pool from which a defaulting party can borrow. Upon default, the group uses the fund to make up the shortfall. It’s still a default and the group will take the same remedial action had the fund had not been used.

“Fractionals” sometimes involve a “vehicle” holding the property, with the co owners as shareholders. An LLP offers several advantages including;

- 1) Protecting other assets from liabilities arising from fractional ownership
- 2) Avoid seizure by creditors or co owners
- 3) Increased flexibility for ownership changes

Can owners dispose of their shares? Most owners are concerned that disposal causes incompatible or unqualified co owners to enter the group. Prohibiting individual disposal requires unanimous consent. The problem is that no other owner may want to buy and there is little incentive for them to pay market price, as the seller must take what he is offered. Therefore, allow individuals to dispose subject to restrictions; such as a right of first refusal. Co owners can only force the sale of the entire property if it is in the agreement. It may be the plan to sell the whole investment at a predetermined future date.

Fractional ownership involves the risks of sharing use and relying on others to fulfil certain obligations. You can’t do what you want when you want! Necessary maintenance might not happen, as a result of co owner default and the whole investment could be lost. There is no way to eliminate this, but there are ways to reduce it. Carefully investigate the potential co owner’s background. Collect payments monthly and pay bills from a group account. Assign essential tasks to specific persons. Have each co owner contribute to a default reserve fund. Allow the group to act quickly against a defaulter.

Finally, use a local lawyer from the UK, specialised in fractional ownership, who operates with a lawyer licensed in the country where the property is located to draft the agreement and structure.

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