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# PIONEERING THE CONCEPT OF TIME-SHARING OWNERSHIP

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The American public's desire for meaningful experiences in leisure-time activities has resulted in a changing demand for new products and services. Particular evidence of this change is reflected in the resort ownership and vacationing trends of the past fifteen years.

Prior to the 1960's, ownership of resort property was limited to the wealthy few. Later, however, leveraged credit arrangements and an increasing propensity to consume permitted a broader market to enjoy the opportunity to purchase a vacation home.

Vacation habits were changing as well. Formerly, families traveled only within a small radius of their primary residence. When vacationing, the tendency was to stay in one place for an extended period of time, often returning to the same recreation area year after year. However, increasing affluence began to affect vacation trends. Ancillary to higher income was the mobility and flexibility made possible by improved transportation facilities. High speed freeways made it feasible for many travelers to enjoy established resort areas such as California and Florida, while jet service was responsible for opening new resorts such as Aspen and Vail in Colorado.

By the mid-1960's, vacationers wanted an opportunity to share in the appreciating value of recreational land and shelter facilities. Real estate sales prices were relatively low, and the resort market absorbed thousands upon thousands of mountainside, oceanfront, and lakefront homes and home sites. Later in that same decade, however, the rapidly inflating costs of land, labor, and materials began to price many individuals out of the vacation home market. Scarcity of prime property necessitated subdivision of cost in the form of condominium projects.<sup>1</sup>

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<sup>1</sup> Land passed over as undesirable for single home construction because of the high cost of preparing roughly contoured land is not as uneconomical for condominium purposes. D. CLURMAN & E. HEBARD, *CONDOMINIUMS AND COOPERATIVES* 10 (1970).

Additional reasons for the growth in condominium projects in the second home market include: (1) recreational facilities at a lower cost per unit than a single home; (2) maintenance of roads and common areas by management personnel, thereby allowing more time for leisure activities; (3) reduction of vandalism because of a managing agent's presence; (4) a leasing or rental pool under which an owner contributes his unit to the pool for a year and the management rents it; (5) a good investment for corporations; (6) a sharp increase in market value compared to the traditional family home; (7) availability of long term financing; and (8) economic independence from fellow home owners in

Evidence of resort condominium growth is readily apparent on the outer islands of Hawaii, as well as the golf and beachfront sites of southern California, Florida and South Carolina.<sup>2</sup>

Vacationers who chose not to purchase resort property continued to travel in increasingly large numbers. Particularly attractive to the vacationing public were the cost savings of group charters and services provided by the prepackaged vacation tours. The early 1970's found the resort developer challenged to provide the benefits of real estate ownership without sacrificing the flexibility and mobility of vacation tour programs. Simply stated, ownership costs needed to be more closely linked with actual time utilization of a resort property.

This author and several colleagues believed the solution was to subdivide the cost of unit ownership into time interests, sufficiently priced in the aggregate to recoup the developer's investment. Sharing a unit's cost would enable more people to own an interest in a vacation home which they could enjoy with their families during their increasing amount of leisure time. Joint ownership of vacation homes was already common in the United States where a number of families purchased a house on the water or in the mountains and agreed among themselves how to share the use. However, the absence of a structured management is a significant shortcoming of this form of ownership.

The originators set out to facilitate the joint ownership approach by establishing a workable plan and providing the management vehicle to implement it. Borrowing from the computer industry, this plan of joint ownership was named "Time-Sharing" and its purpose was to increase the availability of vacation homes and to minimize the inconveniences of absentee ownership.

Time-sharing ownership (TSO) is a relatively simple idea. The objective is to permit each participant to become an owner of his unit with the exclusive right of use during one or more annual periods of his choice, to own only what he can use, and to require each owner to pay a fair share of the common expense.

Basically, a TSO interest in a condominium apartment is conveyed by a deed transferring an undivided fee simple percentage

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terms of a mortgage. 1A P. ROHAN & M. RESKIN, CONDOMINIUM LAW AND PRACTICE § 20.03 (1974) [hereinafter cited as ROHAN & RESKIN].

<sup>2</sup> In 1972, of a total of 2,378,500 building starts, 8% (190,300 units) were condominiums. *Construction Outlook*, ECONOMIC NEWS NOTES FOR THE BUILDING INDUSTRY, Jan. 1974, at 1. In 1973 the condominium market represented 10.7% of the building starts and the National Association of Home Builders predicts that in 1974 condominium starts will comprise 15.2% of the total. *Little to Cheer About*, ECONOMIC NEWS NOTES FOR THE BUILDING INDUSTRY, June 1974, at 1. In southern Florida, condominiums comprised 84% of the housing built in 1973. N.Y. Times, Sept. 6, 1974, at 30, col. 2.

interest in the apartment as a tenant in common along with all other owners of a TSO interest in the apartment and the right to the exclusive use of the apartment for a certain period of time each year. A policy of title insurance is issued to insure a TSO owner that he owns not only an interest in the condominium but also the exclusive right to occupy the condominium unit during designated "use periods." Use periods are structured through a Declaration of Covenants, Conditions and Restrictions (CC&R's). Additionally, the CC&R's include provisions delineating the rights and duties of the TSO owner and authorize the management of each apartment and the TSO interests therein to be vested in a common agent appointed by a majority in interest of the owners.

The TSO format mentioned above is currently underway at Brockway Springs, a condominium development of 78 units located at the North Shore of Lake Tahoe, California. Pioneering the concept of time-sharing at Brockway Springs has taken a considerable amount of time. It is helpful to delineate these pioneering steps to appreciate more fully the difficulties encountered in structuring the current concept.

To facilitate the implementation of time-sharing, it was important to associate with a successful resort developer capable of providing professional condominium management. After a mutual understanding of the TSO concept, the group which developed the idea joined the Innisfree Corporation of San Francisco, an innovator in land developments at Lake Tahoe. Subsequently, Innisfree reached an agreement with Warner National Corporation, the developers of Brockway Springs, to initiate TSO at that project. The criteria suggesting this site included the desirability of the particular parcel, the proximity to winter and summer recreational activities, the ease of dividing the calendar year into use periods, Innisfree's familiarity with the area, and Warner National's desire for the marketing assistance Innisfree could supply.

To understand the difficulties encountered in structuring a viable TSO concept, it is useful to analyze Innisfree's requirements for creating a marketable TSO program. Additionally, it is helpful to outline the necessary steps taken in structuring the current TSO concept to permit certain institutional acceptance.

Four major objectives were established as essential to a marketable TSO program at Brockway Springs. First, the basic documents of conveyance and sale had to be developed to ensure TSO owners of an exclusive right of occupancy of a condominium unit during a specific

portion of the calendar year. Second, centralized administration and management of the unit was essential, including the collection and payment of expenses pertaining to the unit. Third, upon the sale or transfer of a TSO interest, the documents had to further ensure that the transferee would be bound to the TSO plan. Fourth, it was necessary to provide a means whereby individual TSO owners could finance their undivided interests without affecting the interests and liabilities of all present and successive owners.

The Innisfree Corporation, aware of the innovative aspects of TSO, sought legal assistance to structure the TSO program since during this period the TSO embodied concepts for which California had no existing statutory framework.

In addition to conforming to the TSO characteristics desired by Innisfree, three major institutional forces affected the structuring of the present TSO program. These forces included title insurance, the California Department of Real Estate, and financial institutions. Title insurance is necessary to market TSO interests; the California Department of Real Estate must issue a public report authorizing sales of interests in subdivision projects;<sup>3</sup> and financial institutions are needed to assure sufficient mortgage funds for purchasers.<sup>4</sup>

A public report for the TSO program was given to the Innisfree Corporation by the California Department of Real Estate in July, 1972, authorizing the offering of these interests for sale. At that time, the TSO objectives were incorporated in a Memorandum of Sales Agreement which was to be recorded with each TSO deed and would be binding on subsequent purchasers in the nature of an equitable servitude.

TSO sales were initiated in July, 1972 at Brockway Springs. By September, marketing efforts were geared to a major awareness cam-

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<sup>3</sup> CAL. BUS. & PROF. CODE § 11018 (West Supp. 1974), which provides in part: "The Real Estate Commissioner shall . . . issue to the subdivider a public report authorizing the sale or lease in this state of the lots or parcels within the subdivision." Condominiums are specifically included within the definitions of "subdivided lands" and "subdivisions." CAL. BUS. & PROF. CODE § 11004.5(c) (West Supp. 1974).

Cf. N.Y. REAL PROP. LAW § 339-ee (McKinney Supp. 1973), which specifically excludes condominiums from the provisions of Article 9-a of the Real Property Law ("Subdivided Lands Act"). However, condominium offering statements must be filed with the Department of Law of the State of New York. See N.Y. GEN. BUS. LAW § 352-e (McKinney Supp. 1973).

<sup>4</sup> See 12 U.S.C. § 1715y (1970) on the availability of mortgage insurance for condominiums. For a family unit in a project of eleven or more units to qualify, the project must be covered by a mortgage insured under the section. In addition, though the mortgagor may be an owner of up to four units, he must use and occupy one of them. For the procedure to obtain FHA financing of condominiums, see 1 ROHAN & RESKIN, § 9.03 (1974).

paign through the use of press releases and radio and newspaper advertising. The response was encouraging, with over 1,500 inquiries received in the first 90 days of advertising. Deposits were taken on approximately \$400,000 of TSO interests by Christmas of 1972.

In early 1973, Innisfree Corporation elected to suspend sales of TSO interests to reexamine the TSO legal format. This reexamination revealed certain points which required modification and which ultimately led to producing the current format of Innisfree's TSO program. To begin with, the nature of equitable servitudes embodied in the Memorandum of Sales Agreement appeared questionable. As TSO relies on agreements among present and future owners, it was deemed necessary to structure the covenants between owners as covenants running with the land.<sup>5</sup>

TSO is dependent on the enforceability of the CC&R's against all owners, their successors, and assigns. Whether the CC&R's are enforceable depends upon whether they qualify as equitable servitudes or comply with the strict requirements for covenants running with the land.<sup>6</sup> In California, covenants running with the land are governed exclusively by statute.<sup>7</sup> The CC&R's include the right to exclusive use of the condominium during various use periods, assessments for cost of operation of apartments, liens to enforce assessments, selection of the managing agent, and other matters requiring certainty.

During the period when the Sales Agreement was discarded and the CC&R's concept was adopted, a potential problem was discovered that has not yet been solved. The Internal Revenue Service can authorize the federal tax authorities, in enforcing a federal tax lien on the interest of any co-tenant, to sell the entire condominium and distribute the sales proceeds to the owners in accordance with their interests.<sup>8</sup> In an effort to avoid federal partition, Innisfree considered executing a long-term lease, as the developer, with the TSO managing entity which, in turn, would sublease the units to the TSO tenants. Undivided reversionary interests would be conveyed to the purchaser simultaneously with the execution of the sublease. In the final analysis, Innisfree rejected the lease structure as it was deemed unworkable from a marketing standpoint. Since the Internal Revenue Service has rarely forced partition, a low risk factor was involved. Thus, the prob-

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<sup>5</sup> See CAL. CIV. CODE § 1468 (West Supp. 1974).

<sup>6</sup> *Id.*

<sup>7</sup> CAL. CIV. CODE § 1461 (West 1954).

<sup>8</sup> INT. REV. CODE of 1954, § 7403.

lem of the tax lien has been accepted, and its presence is reflected in the current State of California Public Report.

A primary reason for structuring the current TSO program under the CC&R's was to obtain title insurance for the sales. Initially, Title Insurance and Trust Company was skeptical of TSO. Providing conveyance of a separate fee title to each TSO purchaser's period of possession was viewed as a way to avoid "cross fee" interference of mortgage and tax liens on separate TSO interests. However, it was felt that this scheme created the problem of segment possessory rights in fee title. Thus, the structure of tenancy in common modified by the CC&R's was determined to be more reliable.

The California Department of Real Estate, under the California Subdivided Lands Act,<sup>9</sup> has jurisdiction over the development and marketing of condominium projects. The Department issued a Public Report under the Sales Agreement and CC&R's approach to TSO in which it required modification and expansion of the CC&R's to assure owners of sound property management. The concept of TSO is not possible for developers unable or unwilling to provide what amounts to resort hotel services.

The final consideration confronting TSO related to a search for a financing institution which would accept separate TSO interests as security. Innisfree determined that a 25 percent down payment was necessary to prequalify the interest-bearing paper. It was determined that financing by Innisfree would be inappropriate since debt financing called for the prime rate plus five percent.

As TSO was new, most lenders required discount factors that were unacceptable to Innisfree. Additionally, financial institutions would only loan on the conventional market value of a unit and not the total TSO price which was 125 to 150 percent of market value. Financing was finally arranged through an intricate arrangement between Innisfree and AVCO Savings and Loan. AVCO understood the TSO concept as a condominiumization of a condominium and, most importantly, believed that Innisfree's TSO was well planned.

The exact arrangement of financing TSO cannot be generally applied because yield, appraisal, and imagination of lenders vary widely from state to state. However, it is believed that reappraisal of TSO

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<sup>9</sup> See note 3 *supra*. The Real Estate Commissioner, in addition to authorizing sales or leases of subdivisions lots or parcels, must grant consent to modifications in instruments which effect rights of owners of subdivided lands. CAL. BUS. & PROF. CODE § 11018.7(a) (West Supp. 1974).

market value by tax assessors will afford financial appraisers an opportunity to adopt financing methods similar to other conventional condominium projects.

Innisfree, then, has helped to pioneer a concept by which purchasers, given the alternative of ownership of a conventional condominium interest of \$50,000 may instead opt for the opportunity to own several \$6,000 to \$10,000 TSO interests in prime resort areas. The TSO plan, offering a saleable marketing tool, appears to be an idea whose time has come.