

Fractional Vacation Homes as Investments

Second homes can be a good investment if they are in an area where residential real estate is appreciating quickly and there's a strong rental market. They provide a great family getaway, and can offer significant tax advantages. The downside is that the owner is responsible for all the upkeep, from cutting the grass to finding a plumber.

Many families now own second homes at their favorite vacation area or resort. However, some decide that full ownership of a second home is not practical due to the maintenance and upkeep associated with a second home. Fractional Ownership is a simple, practical concept that offers the opportunity to own a fully furnished home, condo, or condo hotel unit at a fraction of the cost of purchasing one in its entirety.

Typically Fractional Properties are exquisitely decorated, fully furnished and include various amenities such as golf carts, big-screen HDTV's, jetted tubs, and fireplaces. They are located on or near the ocean and may be within the gates of a community with additional amenities such as boat docks, pools, and recreational facilities.

Fractional Ownership or "Fractionals" are a form of shared ownership. The concept appeals to those who desire a great deal of exclusivity and opulence in a single location for extended periods of residence, but realize the impracticality of leaving the property empty for extended periods. Fractionals generally are sold in time allotments ranging between 4 and 13 weeks, and are most common in regional destinations that nearby owners can visit several times a year. Unlike partnerships or traditional "time shares," fractionals are undivided deeded interest and can be mortgaged, willed, or passed on to the next generation. The property--a house or condo--is developed by an individual or group and divided into 13 shares or 'fractionals' with each fractional equaling 4 weeks per year, one week in each season. The weeks rotate forward each year.

A homeowners association is formed (much like a typical HOA) to govern the property through budget discussions, plan improvements, elect officers, and plan meetings. Usually a management company is hired to deal with the upkeep and maintenance of the property on a daily and/or weekly basis. The property manager may also manage exchanges among owners or offer owner's available weeks for rent. Their fee is included with all the other typical costs of owning and maintaining a property (taxes, insurance, utilities, etc) resulting in a yearly budget which is then divided among each individual fractional owner as an HOA fee.

Fractional Ownership is a relatively simple and comparatively affordable ownership arrangement in which 4 to 13 individuals or entities individually hold legal title to a single undivided parcel of real estate or a condominium unit. We call the owners "Fractional Owners" in our project documents. The Fractional Owners are referred to in some arenas as "cotenants" to a Tenants In Common (TIC) ownership. This means you share all aspects of ownership and responsibility for the property according to how much of the title you have purchased. Once you acquire title, your interest in your property legally is an equitable interest in real estate. You, along with the other Fractional Owners, enjoy all the usual benefits of ownership of the property: occupy, sell, bequeath, gift, or rent. While also sharing in all the responsibilities of property ownership, the property manager will manage the property, arrange for repairs and

maintenance, and handle the payment of taxes and expense costs. Nonetheless, together with the other Fractional Owners, you collectively retain legal control.

Some owners prefer to hold their ownership in a Limited Liability Company ("LLC") or Partnership ("LLP") to avoid certain legal situations where they could be responsible for the debts or actions of other owners. Some owners want the property itself in an LLC or LLP; so all owners have no responsibility for other owners in most circumstances. The managing cotenant or LLC Manager, if that is how you hold title, will take care of the ordinary paying of bills, setting up accounts, cleaning services, landscaping and so on.

Without an LLC or LLP, the manager is usually the original seller, which changes to one of the owners after all fractionals have been sold.

Only you, on the other hand, as individual owner(s), can execute deeds, mortgages, and leases of your fraction period and all other legal documents affecting legal title to your property. Or you can give written instructions from you, the Fractional Owner(s), to those who work for you.

While many owners pay outright or use home equity loans, direct financing is available through traditional lenders and mortgage brokers in the local market to help you obtain your Fractional Ownership share. Some lenders even specialize in fractional ownership financing. Also, Internal Revenue Code Section 1031 Tax Deferred Exchanges are another frequent source of funds. Your IRA can employ the use of debt to finance the purchase of real estate, but there are some rules to follow. We suggest that you consult with your tax advisor for specific guidance. However, if you have three friends who are looking for similar opportunities, you and your three friends can combine your IRA funds to make the transaction happen. In 1974, the Employment Retirement Income Security Act (ERISA) gave all self-directed retirement plans this option!