

PROS & CONS OF NON-DEEDED TIMESHARING:

John Rogers Burk, Esq.; ARDA Workshop, April 24, 2001

I. LEGAL STRUCTURE

- A. **Units.** Living Units at each resort location are conveyed in fee (or long term lease) to the Vacation Club, a nonprofit corporation.
- B. **Voting Memberships.** The Developer will then have the right to sell to individual consumers voting memberships in the Club. Club memberships include the right to use the Club Units under the reservation system, and the right to vote for the board of directors of the Club and on all major Club decisions, such as amendment of governing documents and the elements of ownership of Club property. If the Club dissolved the members would receive prorata distributions of the Club property or proceeds from the sale of the Club property. The Club will be responsible for management and operation of the property.
- C. **Developer Benefits and Duties.** The Developer may, at its option, add units and resorts to the Club and thereby continue selling memberships, as long as such additions do not substantially increase the assessments of existing members. The Developer is responsible for all the costs of sale but is entitled to all of the proceeds from the sale of memberships. The Developer may vote on unsold memberships but is also responsible to pay Club assessments on unsold memberships.

II. WHAT IS OWNERSHIP? "OWNERSHIP" of property includes several material elements:

- A. Right-to-use.
- B. Power to decide: how to use, how to manage, whether to sell, encumber or rent, and whether to rebuild if destroyed.
- C. Right to receive the proceeds from destruction, sale or rent.
- D. Right to exclude others.
- E. Responsibility for maintenance and repairs.
- F. Power during life or at death to designate a new "owner."

III. IS REAL ESTATE "TITLE" RELEVANT TO OWNERSHIP? No; what is relevant is whether the elements of OWNERSHIP are granted and protected.

- A. "Title" to the property can be held in a trust for the benefit of the beneficial owners (beneficiaries), or it can be held by a nonprofit corporation of which all of the "owners" are voting members.
- B. Legal title is merely a fiction (but still carries the disadvantages) if the real elements of OWNERSHIP are materially restricted, subject to conditions, or may be canceled by the developer or club without the consent of the "owner."

IV. WHAT ARE THE DISADVANTAGES OF A DEEDED INTEREST?

- A. Direct personal liability of the person or entity which holds legal title.
- B. The time, cost and difficulties of foreclosure.
- C. Ancillary (foreign) probate when an out-of-state owner dies.
- D. Clearing title upon condemnation, sale, or substituting another resort or unit(s).
- E. Individual assessment of property taxes.
- F. Delays in recording.
- G. Direct personal liability for environmental contamination.

V. HOW ARE DEEDED INTEREST PROGRAMS FREQUENTLY MISLEADING TO PURCHASERS?

- A. Traditional expectation of appreciation in value from "owning land."
- B. Traditional expectation that a "deed" is permanent.
- C. Substantial restrictions and conditions on OWNERSHIP and rights to cancel and reconvey may be buried in the documents. See II.B above.
- D. The disadvantages of holding legal title are not disclosed.

VI. HOW ARE DEEDED INTEREST PROGRAMS FREQUENTLY MISLEADING TO THE DEVELOPER AND LENDER?

- A. Believing there won't be a securities law violation in the grant of a fee interest.
- B. Believing the Windrifter (lease) income tax consequences won't apply.
- C. The developer may "bootstrap" itself into unnecessarily burdensome regulatory requirements.
- D. Thinking that deeded interests sell better than nondeeded interests.
- E. Thinking that nondeeded interests cannot be financed.
- F. Assuming that state and federal statutes will not apply if the statutes are based on the sale of "services."

VII. DOES SELLING A DEEDED FEE INTEREST PROTECT YOU AGAINST SECURITIES LAW VIOLATIONS? No

- A. A security is the expectation of profit based on the efforts of others. In the leading case where the U.S. Supreme Court established that definition, the seller was giving a warranty deed to real property, but the main motivation and marketing thrust was expecting a profit from the sale of oranges by the seller/manager of the property.
- B. If the purchase price or obligation is collected before title and/or promised improvements can be delivered, the purchase money may be "at risk," and in California, Michigan and a few other states you may be guilty of selling a security, whether the interest is deeded or not.

VIII. WILL LENDERS LOAN ON A NONDEEDED VACATION PRODUCT? Yes; the same concerns exist and can be satisfied in a deeded fee, deeded right-to-use (including lease), and nondeeded vacation product.

- A. The experience and track record of the developer and its team.
- B. A legal structure based on a recognized body of law.
- C. A legal and practical mechanism for controlling inventory.
- D. A legal and practical mechanism for insuring title to the membership and protection and priority of the security interest in the membership.
- E. Assurance that the individual purchasers will receive what they are promised.
- F. Financed by FINOVA, Textron and Prudential Securities.
- G. The receivables have been securitized.

IX. CAN A NON-DEEDED VACATION OWNERSHIP PRODUCT BE SOLD AS WELL AS A DEEDED PRODUCT? YES.

X. ADDITIONAL REASONS NON-DEEDED TIMESHARE MEMBERSHIPS ARE RELEVANT.

- A. "We really sell an experience for a family unit of some sort. That's really what our product is. Whether I'm selling a lot, whether I'm selling a timeshare, whether I'm selling a second home or a retirement home or I'm selling a room at a hotel . . . I'm selling an experience." Peter N. Brown, RRP, "Changing Consumer Values - Moving Into The Twenty-First Century" panel, ARDA Fall Conference, Washington, D.C. November 1995.
- B. "There's terrific inefficiencies . . . that as a Developer you have to pay and they have to pay, and as more credibility comes into the business and major banking and lending institutions come into the

business there's going to be a huge swing toward some form of right to use product." Ed McMullen, *ibid.*

- C. "Timesharing use to be sold as real estate. Then as a vacation experience. But today, . . . vacation ownership is becoming a product that is sold based upon the leisure/lifestyle opportunities it opens up for buyers." "Review and Forecast: Timeshare Integrates More Fully with Hospitality and Leisure Sectors," *Vacation Ownership WORLD*, January 2000, page 7.