
Fractional Ownership in Hawai'i - Vacation Investment in Hawai'i *April 06, 2007*

1. What is fractional ownership in Hawaii? As it sounds, a fraction is a percentage of anything; for land or buildings in Hawaii, it is an ownership of between one-half and one-sixth in any improved property. It is accompanied by the exclusive right to use the property for no less than sixty days per year. Anything less is a "timeshare" as defined in Hawaii Revised Statutes, Chapter 514E. Fractional ownership is simply "cotenancy," meaning the owner is one of two or more total owners. This form of ownership has been around longer than our country has existed. Historically, cotenants either operated under a "cotenancy agreement" or just shared the right to occupy, use, rent, harvest, dig and build on the property in proportion to the various "fractions" that others owned.

2. How is fractional ownership different from condominium ownership?

Condominiums are a different form of cotenancy with rules set up by developers and controlled by the condominium law (either Chapter 514A or 514B, Hawaii Revised Statutes). This special kind of cotenancy was created so multiple people could share a usually small piece of land or one of many boxes of air stacked up along beaches, rivers, canyons or ski mountains where more people wanted to be than could fit on the land in any other way. It allows people to deed, finance and use their interests almost like fee-simple ownership. People can own condominiums in fractions just as they can own fractions of houses, jet planes and boats.

3. Is Fractional Ownership the same as timeshare? NO. Timeshare is a special kind of use that may or may not include ownership of land (sometimes it is just club membership, "points," or as little as a 1/102nd cotenancy interest in land). Most often it is one week per year. The law in Hawaii says that if you use a property for less than sixty days, then it IS a timeshare. **TIMESHARE IS THE EXCEPTION TO TRADITIONAL COTENANCY** and does not apply to proper fractional projects. If they sell less than a sixty-day period of use, they are selling a timeshare and can go to jail and pay substantial fines.

4. Why are some subdivisions and condo projects amending their project documents to stop fractions? It is the old "The Sky is Falling" approach to something new. Most people, understandably, don't trust timeshares and their questionable value as an investment and the negative publicity they used to get. One reasonable fear is that when fifty-two different families with no real investment in the project show up every year they trash the furniture, wear out the common areas, and don't really care about the project that, for them, is no more than a hotel room for a week. The people who own these fractions actually own from eight to fifty times more interest in the property than a weekly timeshare owner. Average demographics reveal the following average statistics for owners of fractions in America:

Age: 45-60

Income: \$250,000-\$750,000 per year

Occupancy: 6-8 weeks per year (the same as if they owned a second home by

themselves and left it empty or rented the rest).

Acquisition: Half pay cash, half finance the purchase.

The occupants of fractions are expected to spend more than the average hotel visitor and actually multiply visitor expenditures because the homes and condos will have higher occupancy than second homes that often sit empty.

5. Why would I want to fractionalize my own home or condo? As owners of Hawaii resort and high-end real estate often find, children grow up and many friends don't come back year after year. As maturity and retirement approach, we want to travel more and perhaps only spend a few months per year here in paradise. Fractionalization will allow the sale of as much time as you don't need. With the dramatic escalation of prices in the past ten years, a fractional sale will often generate enough income to buy a second home or multiple fractions in other places or deposit the money in the bank and spend time traveling and visiting family and friends. If someone is trying to sell a home or condo in this sluggish market, fractions open an entire new world of buyers who cannot afford full ownership but can afford to spend a quarter or less of the cost of whole ownership to get what they really want - a few months in paradise!

6. I am on an association Board of Directors. Why should I be worried about? What may I do if someone starts a fractional project in one of our homes or condominiums? First, you need to understand the definition of fractions. Then determine whether what is proposed or has been done is in fact a fraction. If you have attorneys on retainer, you should discuss as a board whether to have your attorneys examine the proposal or documents used and see if they violate your project documents or some other law. Once you have decided whether what is proposed or done has violated law or project documents, you should consider taking action. If it violates your documents, you demand cessation. If it violates law, turn them in to the authorities. If it does not violate law or project documents, you should consider whether the board thinks it is a bad idea or an acceptable one. If bad, your attorneys should suggest a document amendment which will eliminate the future use of such ownership in your project (but will not be able to affect those who have fractionalized prior to any change to the contrary). Your documents may dictate whether you should call a meeting of owners to discuss the options or circulate proposed changes to the owners. Be sure you give a reasonable opportunity to those who want to fractionalize to present their side of the case and obtain votes to sustain their position. In this regard, a meeting of members is the surest way to avoid litigation by those who might claim their rights were impaired without a meaningful opportunity to be heard. Then, once the matter has been put before the members and a decision is made, you will know whether fractions remain a viable form of ownership in your project.

7. What does fractionalizing do to the value of fractionalized units? What does it do to the value of units that are not fractionalized? Any time real estate is broken into smaller pieces, the value per piece usually goes up. That has been the experience in all of the United States where fractions are actively developed and sold. A rough rule of

thumb is that a property broken into fractions is worth from thirty to forty percent more than in whole ownership. Commonly, a buyer will pay perhaps one-fourth to one-fifth of the whole value to purchase a one-sixth interest in the land or buildings.

8. What happens to the value of property when it has been fractionalized? The history in the industry is that fraction values track the values of unfractionalized property. If homes go up twenty percent, the fractions go up twenty percent – the same for condos. One project that has been on Maui for nearly ten years has had this experience, according to the title company that tracked the resale values. As for taxes, current laws will allow counties to assess the fractional properties according to the prices of fractions sold but usually cannot raise taxes on the unfractionalized properties.

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