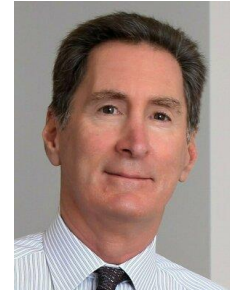


# The Thorny Road Ahead For Fractional Home Ownership

By **Paul Weinberg** (October 28, 2022)

We live in a time of computers, software and other electronic assistance in an economic drive to maximize the use of any possession in the forefront of life.

The ride-sharing applications Uber and Lyft; short term property rental services established by companies such as Vrbo and Airbnb; personal car rental companies such as Turo Inc. have all upended the established practices and procedures of how people rent homes, rent cars and go from place to place.



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Now, with the new fractional ownership services such as Pacaso Inc. and Equity Estates Fund, users can participate directly as a part owner of an ownership interest in a vacation home.

Not surprisingly, though, this upending of the established norms carries with it the detritus of unintended consequences and side effects.

In the very same way that the ride-sharing services of Uber and Lyft pit themselves against traditional taxi services, and the short-term real estate rentals from Vrbo and Airbnb compete directly with the services of hotels and motels, the new players are wont to offer the luxury of a vacation home to middle-class buyers.

As one of its proponents, Pacaso, related in litigation it filed for declaratory relief and damages against a city attempting to ban it:

Pacaso ... launched in 2020, seeking to "open the second home market, which has traditionally only been accessible to affluent and predominately white buyers," by simplifying and streamlining the co-ownership process that makes second home ownership possible at a more accessible price point.[1]

Not surprisingly, notwithstanding the emotionally attractive and pure motives, the neighbors in the neighborhoods where these projects are located are getting angry. The neighbors' concerns, in essence, mirror the very same concerns that they had to the proliferation of short-term rentals, and alcohol and drug rehab homes.

Similar to short-term rentals, the projects can draw complaints about nonresident vacation behavior, noise, trash, overloaded on-street parking, overuse of alcohol and rowdy behavior.

Concerns also mention commercialization of the neighborhood and impacts on housing affordability due to increased vacation homes and reduced housing.

An Aug. 29 study on the effects of fractional ownership prepared for the city of Newport Beach, California, by Sagecrest Planning+Environmental cites a 2022 law review journal article forecasting further negative effects:

The Mitchell Hamline Law Journal of Public Policy and Practice published a journal article that found that "The increasing commodification of single-family homes has

had cascading effects on housing and on communities in general." Fractional housing is shared among various owners, as a result, an increase in the number of units could decrease the demand for hotel rooms. This would likely result in a reduction in the amount of transient occupancy tax accrued by the City.[2]

A small, bucolic city located in the Napa Valley area of Northern California, St. Helena, is the subject of a lawsuit by one of the fractional homeownership providers, Pacaso.

The neighbors in St. Helena have congregated and impressed upon their city council the necessity to regulate and, if possible, ban fractional ownership to restrict use of vacation homes to family members and other related parties in a family simply using the single-family home for the family's own vacations.

The city of St. Helena has used its Municipal Code, Section 17.112.130, to compare and analogize the new fractional ownership model to a timeshare.

The city attorney, in a memo to the City Council regarding the effects of fractional ownership on neighborhoods and the propriety and legality of attempts to regulate it, dated July 14, 2020,[3] pointed out that the State of California's Department of Real Estate regulates the advertising and sale of timeshare pursuant to the Vacation Ownership and Timeshare Act of 2004, codified in Business and Professions Code Section 11210.

That law defines a timeshare plan to mean

any arrangement, plan, scheme, or similar device, other than an exchange program, whether by membership agreement, sale, lease, deed, license, right to use agreement, or by any other means, whereby a purchaser, in exchange for consideration, receives ownership rights in or the right to use accommodations for a period of time less than a full year during any given year, on a recurring basis for more than one year, but not necessarily for consecutive years.[4]

So now the issue is thrown into relief: Statutory law and St. Helena's local ordinance heavily regulate timeshares.

Pacaso attempts to circumvent the statutory scheme by forming California limited liability companies and selling shares in them to a maximum of eight purchasers for each property. In other respects, though, the new owners are only allowed to receive ownership rights in the property for a period of time less than a full year during any given year.

St. Helena's own local ordinance defines a timeshare estate as "an ownership or leasehold estate in property devoted to a time-share fee (tenants in common, time span ownership, interval ownership) or a time-share lease." The city attorney draws a distinction, however:

Timeshares, thus, are somewhat similar to short-term rentals and fractional ownership hotels but differ from both in important ways. The City defines short-term rentals as a use in which overnight accommodations are provided to guests for compensation for periods of less than thirty (30) days in a single-family dwelling and are only authorized with a short-term rental permit.

Controversy therefore extends to, and past, the question of ownership to land on the issue of use. Who is using the home, how are they using it, for how long and what are the effects of that use? The city attorney's report also points out the practical problems of enforcing timeshare regulations against a fractional ownership house:

There are also significant practical challenges to implementing and enforcing the existing timeshare regulations. Absent a proposed new development to specifically construct a timeshare project, the City does not know when a residence becomes a timeshare, since the ownership change is a private transaction between private parties. The City does not have an easily available means to scrutinize such agreements or monitor the terms of particular ownership arrangements.[5]

Cities are trying to grapple with this problem armed only with their existing zoning laws, municipal codes and regulatory processes.

For example, in Park City, Utah, fractional ownership properties are allowed in commercial zoning districts, in high density residential development districts and the same zones where timeshares and private residential clubs are allowed. They are prohibited in historic, single family and estate zoning districts.

They also require the approval of a conditional use permit for public hearings and require a management plan by responsible party, maintaining the property, noise and occupancy control, prohibition of nightly rentals, on street parking, commercial activities and signs as well as a business license.[6]

Sagecrest Development's report identified jurisdictions all over the U.S. that are grappling with this problem and trying to regulate it, including all along the California coast, the California desert, California's Lake Tahoe, Vail, Colorado, the village of North Haven, New York, and Ft. Lauderdale, Florida.

Many of the cities in California would like to prohibit fractional housing in its entirety, including Pacific Grove. Others want to regulate the properties as they would timeshares.

The ongoing density, noise, trash and other excessive burdens placed on single family residential neighborhoods are not alleviated by the ownership model that the fractional ownership companies are proposing, for the precise reason that the time periods of occupying are quite short and, thus the occupants don't really feel obligation to be sensitive to the concerns of the neighbors or the neighborhood.

The ownership interest in the fractional community is really not significantly different from that of a timeshare; each grants a fee interest to the owner. The only difference is the fractional owner gains a one-eighth interest in a limited liability company to obtain ownership; the timeshare owner gains a fee interest to, generally, two weeks a year of the unit.

All the side effects of such a temporary arrangement exist in fractional ownership; the manager doesn't live there and doesn't have any real obligation to be sensitive to the neighbors. The owners don't really live there, either; they don't maintain their principal residence there and they don't have any motivation to keep the neighbors happy.

Hotels and motels traditionally are built in commercial areas for this very reason; the transitory nature of the occupancy and the fact that there is high turnover and its attendant impact on noise and trash and parking are better suited to a commercial area because, by definition, they really are a commercial use.

This point only reinforces the limning out of the primary difference between fractional ownership and actual home ownership; the use is transitory. The family or related parties that may own a vacation home won't be renting it out to third parties because, under most

jurisdiction's laws, they can't as that would constitute a short-term rental. As direct owners, they have every motivation to maintain the property and to maintain good relations with the neighbors.

This viewpoint is shared by thirteen cities considering fractional ownership a form of timeshare[7] and four of them have revised their definition of a timeshare, four others issuing cease and desist letters and one imposing a current moratorium to study the problem.

Pacaso complains in its April 2021 lawsuit that its homeowners have

inherent and inalienable rights inherent to owning property, which include the right to possession, to control, to use and quiet enjoyment, to privacy and to exclude others, to sell the property, to physically be on the property, to leave the property, to choose who else can be on the property, to build or alter the property, to make improvements or refurbish the property, and to sell or dispose of the property, among many other rights.[8]

This is, at its core, an essentially disingenuous argument. The management agreement certainly will contain language significantly inhibiting any construction or alteration of the premises without the unanimous consent of all the owners and management entity. The units are set up to afford maximum flexibility for people coming in and out of them on a regular basis.

Altering the aesthetic or the layout that would in any way inhibit that use most certainly would be prohibited and therefore, the analogy to a timeshare is clear. The further statements in the complaint identifying the motives of the new owners are disingenuous as well:

Pacaso homeowners are long-term oriented ... and have materially different incentives with respect to their conduct, use and treatment of the home as compared to short-term renters. This is because Pacaso homeowners are invested in the home, its surrounding neighborhood and community, and the long-term maintenance and success of the property and community at large.[9]

Pacaso's lawsuit avoids the glaring truth that timeshare owners aren't renters — they're owners. Timeshare owners can sell their interest, too. So fractional homeowners are no more directly invested in the home or the surrounding neighborhood and community than timeshare owners are; they just aren't there long enough, and they have no flexibility nor any economic incentive to further improve otherwise more valuable the neighborhood as well.

Just imagine in your own mind: Would a fractional owner who is allowed a maximum of 45 days per year, nonconsecutively, to stay in a home, join a neighborhood association or participate in neighborhood events? Why would they? For that matter, how would they even know of them if they aren't there regularly enough to be so advised?

The decision to ban fractional ownership outright is a political football. The affected planning commissioners know it, too; the Newport Beach City Council has referred to its Planning Commission the question of whether the fractional ownership model should be banned outright in residential neighborhoods.

Planning commissioners realize that there are political as well as land use implications in

this decision; Pacaso proponents claim that, because the properties are held in title by limited liability companies, it could hurt other nonfractional ownership owners to hold their properties in limited liability companies for liability protection.

Planning commissioners are concerned that they don't want to injure long time owners in regulating use. They do understand, however, short-term rentals and sober living homes have provided a concrete example of how a neighborhood changes from a residential use to a commercial use.[10]

The conclusion is really inescapable; fractional ownership is a commercial use, not a residential one. Owners using a property only sporadically without family or other close emotional relationships don't have the motivation to behave toward the property or, for that matter, the neighborhood, as a permanent single-family resident would. They aren't there often enough; they're not emotionally invested in it enough.

Many of the neighborhoods that Pacaso and others are attempting to invest in are savvy long-term residents with the means and sophistication to obtain legal counsel and the assistance of others to regulate or outright ban fractional ownership.

A relatively easy conclusion to make here is that the founders of Pacaso, founded in 2020 by former Zillow executive Spencer Rascoff and Austin Allison, did not plan on this level of opposition nor did they or their company do any significant community outreach to try to determine if there were solutions to the issues that the neighbors raised.

The complaints concern noise, trash, care toward the property — a common complaint is that Pacaso, to accommodate short-term use, closes off the garages of these homes to install cabinets and other facilities for towels, other equipment to permit rapid turnover, thereby forcing more on-street parking — and all the other commercial issues that timeshare and, for that matter, hotels and motels raise.

The parties' positions in this litigation will, as it did for sober living homes, go on for a long time and be hard fought. Likely, though, if fractional ownership is allowed it will be heavily regulated; the sheer volume of opposition makes that clear.

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[1] Pacaso Inc. v. City of St. Helena (2021) Case No. 21-cv-02493-WHO, Order Granting Anti- SLAPP Motion to Strike Fifth Cause of Action, Pages 1 and 2.

[2] Sagecrest Planning+Environmental, Report to City of Newport Beach, Fractional Homeownership, August 29, 2022, Page 3.

[3] Report to City Council of City of St. Helena of July 14, 2020, by Karen Ueda, City Attorney, Page 1.

[4] Business and Professions Code Section 11212(z); Report to City Council of City of St.

Helena of July 14, 2020, by Karen Ueda, City Attorney, Pages 1 and 2.

[5] Report to City Council of City of St. Helena of July 14, 2020, by Karen Ueda, City Attorney, Page 3.

[6] Report to City Council of City of St. Helena of July 14, 2020, by Karen Ueda, City Attorney, Pages 4-10.

[7] Carlsbad, CA, Carmel by the Sea, CA, Hermosa Beach, CA, Monterey, CA, Village of North Haven, NY, Pacific Grove, CA, Palm Desert, CA, Palm Springs, CA. Park City, UT, South Lake Tahoe, CA, Sonoma, CA, St. Helena, CA and Truckee, CA.

[8] Pacaso, Inc. v. City of St. Helena, Complaint, Page 14 at Lines 14 through 19.

[9] Pacaso, Inc. v City of St. Helena, Complaint, Page 16, Lines 19 through 23.

[10] Interview with Planning Commissioner Erik Weigand of City of Newport Beach, California Planning Commission; Thursday, October 20, 2022.