THE NATIONAL LAW REVIEW

Structuring a Timeshare and Hotel Mixed-Use Project

Wednesday, May 16, 2018

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Construction Law
Real Estate
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Many hotel and timeshare developers have been motivated by the nature of the current urban real estate economy to structure large projects in a manner that maximizes all economic income opportunities. The rising cost of land puts further pressure on developers to utilize every available profitable option and minimize risk.

In many cases, especially in urban settings, buildings consisting of a single use are either too difficult to finance, or the economics of the project do not pencil-out. These issues incentivize developers to engage in creative solutions, often leading to the utilization of a mixed-use building structure that contains both a hotel and timeshare component. Depending on the project's particular needs, a timeshare project may also be combined with other mixed uses. For example: (1) a timeshare building with a residential apartment component (consisting of whole ownership and/or rental apartments); (2) a timeshare building with a hotel component; or (3) a blend of examples (1) and (2). This article will discuss (a) the methods a developer can utilize to structure a timeshare and hotel mixed-use project; (b) the practical and legal implications to be considered (including financing benefits); and (c) a recent case study in which the hotel and timeshare mixed-use concept was utilized.

Structure

The nature of the timeshare product will typically dictate that in a mixed-use structure, the timeshare component be separately owned from the hotel component and the rest of the project because timeshare interests will be sold to individual purchasers. Traditionally, the condominium regime is the most recognized method to accomplish the vertical subdivision necessary for a mixed-use project to be owned by multiple owners. Developers should be aware of condominium laws and timeshare laws and the multitude of restrictions and requirements that vary from state to state.

For example, the formation of a condominium requires filing a declaration of condominium and the formation of a condominium association that complies with the laws of the state in which the project is located. The project declaration should include a three-dimensional legal description, which will allow for the creation of units that can be further subdivided by the developer. The condominium governing documents will set forth how the property will be operated and managed, and how the expenses associated with such operation and management will be allocated to owners.

While the condominium structure is the most common method for creating mixed-use projects, there are many downsides associated with utilizing this structure to effectuate the subdivision of the components. The primary drawback is typically the requirement that the developer relinquish control of the condominium owners' association and the owner democracy and governance issues that may result from the turnover of control. The requirements related to the transfer of association control from developer to owners vary from state to state and may be required regardless of whether the condominium is residential or commercial in nature. Further, state laws typically contain restrictions on how common expenses can be calculated—leaving less room for creativity as to what percentage interest may be assigned to each condominium unit. Some states require that these values be based on a number of units, square footage, value, impact on use, or a hybrid of these methods.

There are also additional expenses to be considered by the developer in creating a condominium; examples include state filing requirements, regulatory costs, obtaining plats and plans, legal fees, increased insurance costs, etc. Given these additional costs and restrictions imposed by the condominium regulatory scheme, a developer may find that using the condominium regime as the basis for structuring the project is unnecessarily onerous.

Three-dimensional platting offers an alternative method for developers to establish a mixed-use structure. This method allows for the subdivision of a project into different parcels based on three-dimensional airspace, established by platting parcels on an airspace subdivision map that is filled with local agencies. This method is ideal as compared to creating a condominium because it allows for the platted parcels to be owned separately but does not require the formation of a condominium association and its inherent governance issues. However, the timeshare component of the project will need to be dedicated to some form of a timeshare instrument to create the timeshare plan (i.e., a timeshare declaration). Unfortunately, despite the convenience of three-dimensional platting, this method is not accepted in most jurisdictions. Very few local jurisdictions expressly permit three-dimensional platting, while other jurisdictions that have adopted it generally lack clear codes and regulations.

Regardless of what method the developer utilizes, the developer must still tie the various components of the project together. In order to accomplish this, a shared building agreement (sometimes known as a reciprocal easement agreement, or such provisions may be contained in a declaration of covenants, conditions, easements and restrictions) provides an effective solution. A shared building agreement grants easements to the multiple owners of the project which allow access to the parts of the project that will be used by or serve all parts of the project, often referred to as shared areas. Examples of shared areas include amenities, elevators, stairways, roofs, utility systems, parking, and other structural components. This is particularly important for a mixed-use project, as hotel guests and timeshare owners will likely have access to shared amenities, the staff will need joint use of the back-of-house shared facilities. The shared building agreement may also address limited shared areas, which are shared areas appurtenant to a particular parcel or group of parcels (for example, signage or an elevator serving only the residential portion(s) of the project would be a limited shared area to the particular parcel(s) which it serves). The shared building agreement will provide easements for maintenance of the shared areas and limited shared areas, designate the parties responsible for maintenance of each, and how the maintenance costs are allocated amongst the various owners.

Establishing a shared building agreement requires determining the allocation of the common expenses associated with the shared areas upfront. There are many methods to achieve an equitable allocation, for example, pro rata based on square footage, equal costs per unit, pro rata based on benefit received or burden created, or pro rata based on current or projected usage. Often, these methods are blended to achieve an equitable result. Further, the governing documents will detail mechanisms to enforce payment of these costs, as the obligation to pay shared expenses is typically secured.

Case Study

An example of a recent mixed-use development project that has utilized the shared building declaration approach is Wyndham Grand Clearwater Beach Resort, one of the largest mixed-use resort complexes in the Clearwater, Florida, market. The resort is comprised of two towers—the hotel tower contains 345 hotel units and the condominium tower contains 105 purpose-built timeshare condominium units. Both towers sit atop a podium.

Throughout the podium, the resort contains shared amenities and operational facilities such as a resort-quality swimming pool and pool deck, a fitness center, a full spa, restaurants, bars, beach access, a front desk, approximately 24,000 square feet of meeting and event space, and 550 parking spots. The developer of the hotel, K&P Clearwater Estate, LLC, was seeking the opportunity to reduce the developer's final development and operational costs. The developer teamed up with Wyndham Hotel Group for the hotel management and also negotiated a phased sale of the condominium units to Wyndham Vacation Ownership for the sale of the condominium units.

The mixed-use nature of the resort added several complexities to the negotiations, requiring the legal team to identify novel solutions to establish flexible ownership and management terms and to solidify the logistics of the shared amenities — all while balancing the competing interests among the various stakeholders. Utilizing a shared building agreement, the hotel tower and the timeshare condominium tower were each designated their respective use rights, operational responsibilities, and cost obligations. This allowed each tower to manage and control its own operations, while maximizing the economies of scale by sharing amenities, employees, operating spaces, and expenses — resulting in a win-win situation for both the hotel developer and Wyndham. The loan negotiations were particularly complex, as the original mortgage encumbering the property had to be split into two mortgages covering each tower, in order to allow for the mortgage to be released as the phased closings of the timeshare condominium units took place.

Financing Considerations

From a financing perspective, using one of the three-dimensional platting methods identified above can be ideal for a developer because it allows a developer to finance the separate components of a mixed-use project without necessarily creating a condominium for the entire project (although a developer may still need to create a condominium on those portions that are being conveyed). This will also allow the developer to convey one or more of the components and separately release it from the mortgage. Hotel developers specifically benefit from this arrangement, as the ability to take out equity on certain portions of the project helps the project pencil-out and offers an improved loan-to-value ratio, making financing or refinancing possible. Consumers also benefit when multiple parties contribute to the maintenance and replacement of the shared areas, as this apportions more funds toward developing and maintaining nicer amenities.

Drafting the legal provisions of the shared building agreement requires a certain degree of experience and precision to ensure that the document covers all essential elements without unduly burdening owners. Despite the complexities described above, the shared building agreement provides the greatest degree of flexibility and enables developers to develop a project that will attract both lenders and purchasers. Success all around!