

State of California  
Department of Real Estate

The Great Seal of the State of California is a circular emblem. It features a central figure, Minerva, holding a grizzly bear's paw. The seal is surrounded by the text "GREAT SEAL OF THE STATE OF CALIFORNIA" and "EUREKA" at the top. The word "CALIFORNIA" is written at the bottom of the seal.

**TIME-SHARE MANUAL**  
Guidelines for Processing  
Time-Share Plan Applications  
for Public Report

Subdivisions - Technical Section

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# TIME-SHARE MANUAL

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# THE CALIFORNIA REGULATORY PROCESS FOR TIME-SHARE OFFERINGS

## Types of Time-share Plans Regulated by the DRE

The California Department of Real Estate (DRE) regulates the initial setup and sale of all California and out-of-state time-share plans, that are offered for sale in California.

## Definitions - Time-Share Plan, Estate, Use and Time-Share Interests

Definitions of the different types of time-share plans are found in the Real Estate Law as follows:

- Time-share plan defined – Business and Professions Code Section 11212(z)
- Time-share estate defined – Business and Professions Code Section 11212(x) (1)
- Time-share use defined – Business and Professions Code Section 11212(x)(2)
- Single site time-share plan defined – Business and Professions Code Section 11212(z)(1)
- Multisite time-share plan defined – Business and Professions Code Section 11212(z)(2)
- Specific time-share interest defined – Business and Professions Code Section 11212(z)(2)(A)
- Nonspecific time-share plan interest defined – Business and Professions Code Section 11212(z)(2)(B)

## Department Responsibility

The Time-share Act of 2004 charges the Real Estate Commissioner with the responsibility of assuring that purchasers of time-shares interests receive everything for which they bargained. A Time-share Plan Conditional or Final Public Report must be issued and a copy given to each purchaser prior to the execution of a sales contract for a sale of a time-share. A copy of this report must also be given to any member of the public who requests one. The Time-share Final Plan Public Report is issued only after the developers comply with the provisions of all the applicable laws and regulations.

## Exemption From Corporation Code 25100(f) Defined

Pursuant to Business and Professions Code Section 11218, a time-share interest in a time-share plan that satisfies all the requirements of the Time-share Act of 2004 shall be deemed an interest in subdivided lands or a subdivision for the purposes of subdivision (f) of Section 25100 of the Corporations Code. Their sale may be exempt from qualification unless the offer is coupled with an investment contract, including such features as a mandatory rental pool. This means that in practically all time-share sales, the transactions can be handled by real estate licensees. No securities license is usually necessary. However, if investment contracts are being sold in connection with a time-share, a securities license may also be necessary. Developers and their marketers should check with the Corporations Commissioner for clarification.

## History – Time-Share

The Subdivided Lands Act was amended effective January 1, 1981, to include time-share estates and time-share uses; however, the Department had jurisdiction prior to that date over time-share estates. In fact, the Department had issued Public Reports on 26 time-share projects before 1981. The first time-share Public Report was issued on *The Brockway Springs of Tahoe Condominiums* when the Public Report was amended on June 30, 1972, to accommodate 1/11 interests in the remaining condominiums.

Time-share use offerings in hotels, motels and apartment houses were exempt from our jurisdiction before January 1, 1981. After the law was changed to give the Department jurisdiction over these offerings, it was also modified to allow a “compliance grace period.” This meant that if the previously exempt projects made timely filings with the Department of Real Estate for Public Reports, they could continue their sales programs until Final Public Reports could be issued. This also mandated that the Department had to allow sales to continue unless we were able to prove that continued sales would result in a dangerous situation for the time-share purchasers. There were 26 “compliance grace period”

applications. Some obtained Public Reports and others have voluntarily suspended sales, have abandoned their filings or have had their application denied by the Department.

Since January 2005, time-shares have not been regulated under the Subdivided Lands Law. Rather, a separate chapter of the Business and Professions Code, the Vacation Ownership and Time-Share Act of 2004 (Business and Professions Code Sections 11210 et seq.), was created for the regulation of the time-shares. This had several implications that change the way DRE processes applications for time-share public reports that is much different from how public reports subject to the Subdivided Lands Law are processed. Some key differences:

- The developer is entitled to purchase monies following the seven-day cancellation period if the time-share interest is free and clear of blanket encumbrances and the project is completed or the developer has posted a bond to assure completion (Sections 11243 and 11244 of the Business & Professions Code).
- If a CPA employed by the developer or an independent CPA certifies the time-share association budget as prescribed by Section 11240(f), the DRE will not review the budget. All time-share budgets must be certified, but the budget may be examined by DRE to confirm the accuracy of the certification if the budget is not certified by an independent CPA, a CPA employed by the developer or an individual or entity acceptable to the Commissioner to conduct the review.
- There are no reasonableness arrangements applicable to management documents for time-share plans. Sections 11265 through 11275 set forth the provisions to be included in management documents. For the most part, there is no room for discretion from those provisions of the statutes. There are no regulatory arrangements for reasonableness comparable to Sections 11018.5(d) or (e) of the Business & Professions Code.
- The time-share instruments shall be in compliance with applicable laws of the state or jurisdiction in which the time-share property or component site is located, and if a conflict exists between the affirmative standards of the laws of the situs state and the requirements set forth in the Time-share Act, the law of the situs state shall control.
- Time-share plans are exempt from certain portions of the Common Interest Development Act, commencing with Section 1350 of the Civil Code as specified in Code Sections 11211.7(a) and (b) of the Time-share Act of 2004
- Time-share purchase contracts must include information as prescribed by Code Section 11238(d) of the Time-share Act of 2004.
- The only statutory time frame for processing final public report applications is the requirement that DRE has 60 days from the date of receipt of an application for a public report to provide a list of deficiencies to the developer.
- Preliminary, conditional and final public reports may be issued for both in-state and out-of-state time-share plans.
- It is mandated by Section 11234 of the Business & Professions Code that the developer prepare the public report and that the public report include the specific disclosures as required by that statute. DRE does not prepare time-share public reports. Developers and SRPs should be directed

to the DRE website for forms RE 622H, RE 622I, RE 622J-1, RE 622J-2 and RE 622J-3 for instructions for preparation of time-share public reports.

The regulatory process for approving Public Reports for time-share plans is complex, cumbersome and expensive. Only the most highly trained Subdivisions Deputies are assigned to handle them. The legal fees for setting up the Trust, the Declaration and the Bylaws can be substantial.

## **JURISDICTION**

A time-share plan may take one of two basic forms:

A “Single site time-share plan”, defined in Section 11212(z)(1) of the Code is the right to use accommodations at a single time-share property.

A “Multisite time-share plan includes either (1) or (2) below:

(1) a “Specific time-share interest” which is the right to use accommodations at a specific time-share property, together with use rights in accommodations at one or more other component sites created by or acquired through the time-share plan’s reservations system (Section 11212(z)(2)(A) of the Code). Regulation 2805.9 includes requirements that there be a priority reservation right written into the time-share plan documents to allow the purchaser of a time-share interest to a period of time (not less than 60 days) during which he or she will be permitted to reserve occupancy in the specific site without competition for space by owners of interests in other component sites, together with the right, on a non-priority basis, to reserve accommodations in component sites.

(2) a “Nonspecific time-share interest” which is the right to use accommodations at more than one component site created by or acquired through the time-share plan’s reservations system, but including no specific right to use any particular accommodations (Section 11212(z)(2)(B) of the Code). This means that purchasers compete for the right to use and occupy accommodations in any of the component sites with every other purchaser of a time-share interest in the time-share plan.

“Accommodations” means any apartment, condominium, unit in a stock cooperative, cabin, lodge, hotel room, or other private or commercial structure that has toilet facilities, available under applicable law for use and occupancy as a residence. Accommodation also means any unit or berth on a commercial passenger ship (Section 11212(a) of the Code).

A time-share plan is subject to the jurisdiction of DRE and requires a public report if the time-share plan consists of 11 or more time-share interests, has a term of more than three years and where the purchaser’s total financial obligation will be more than \$3,000 during the term of the time-share plan (See Regulation 2805, which defines “Developer” and Section 11211.5(b) regarding exemptions from the Time-share Act of 2004.)

### **Purchasers of 11 or more time-share interests in a Time-Share Plan**

If a time-share owners’ association or anyone else acquires 11 or more time-share interests from the original recipient of a Public Report or from someone who succeeded to the interest of the original recipient of a public report, the association or anyone else needs a Public Report before they may offer time-share interests for sale (see Regulation Section 2805).



An owners' association may acquire inventory from individual time-share owners through foreclosure or in lieu of foreclosure. As long as that inventory does not include 11 or more time-share interests that someone acquired from the original recipient of a Public Report or its successor-in-interest, the association would not need a Public Report before marketing those interests. There may be occasions when an association has acquired inventory consisting of more than 11 time-share interests from the original recipient of the Public Report or its successor-in-interest and other inventory from individuals. The association would then need a Public Report only for those 11 or more time-share interests it acquired from the original recipient of the Public Report or its successor-in-interest.

An owners' association would be required to apply for a Public Report if a Public Report for the time-share project was never issued, the project consists of 11 or more time-share interests and the association intends to make sales in California. This may occur with respect to both in-state and out-of-state projects. In this case the source of the interests the association acquired is of no importance. A Public Report is required in any event.

### **Inducement to Out-of State Solicitation**

If a California resident is solicited by any written or oral communication, except as provided in Section 11217 of the Code, from a source outside the State of California with the intent to induce that resident to attend a time-share plan sales presentation, and that time-share plan consists of 11 or more interests, then that time-share plan is subject to regulation under the Time-share Act of 2004.

### **Advertising**

California law does not require that time-share advertising material be approved prior to use, whether the project is in or out-of-state. Regulation 2811 contains the specific advertising standards that must be adhered to by time-share developers within the meaning of Section 11245 of the Code..

Refer also to Sections 11245, 11283, 17500, 17537, 17537.1, 17537.2 and 17539.1 of the Business and Professions Code. Violations of advertising regulations are submitted to DRE Enforcement. Desist and Refrain Orders may be issued to control false, untrue or misleading advertising.

## **APPLICATION FORMS**

- **Real Estate Form 668 – Timeshare Plan Instructions.** The instructions contained in this form are to be followed by all applicants. This form lists most Department of Real Estate forms that may be needed in filing for a Time-Share Plan Public Report.
- **Real Estate Form 668A –Notice of Intention Time-Share.** This Application is to be completed and submitted by all applicants for specific time-share interests in single-site or multi-site time-share plans.
- **Real Estate Form 668B. .Notice of Intention (Non-Specific Time-Share).** This Application is to be completed and submitted by all applicants for non-specific time-share interests. A separate RE668B must be submitted and fee paid for each location of a multi-site plan that include a non-specific time-share interest and which is not currently covered by a California public report.

- **Real Estate Form 635C – Public Report Amendment/Renewal Application (Time-Share ). This Application is used to amend or renew a Time-Share Public Report. A separate 635C must be completed and fee paid for each single-site time-share plan or each location of a multi-site time-share plan that includes non specific time-share interests subject to amendment or renewal.**

### **Master File Documents**

In order to avoid having to submit duplicate documents when a developer is submitting multiple applications if, for example, the time-share plan includes multiple phases, the RE 668A provides for the designation of a file as a “master file.” Documents that DRE considers “master file” documents are referred to in the RE 668A and the developer by its answers to specific questions indicates whether documents submitted are to be master file documents.

### **SUBDIVISION MAP ACT**

The creation of undivided interests in a single parcel of real estate does not constitute a subdivision under the California Subdivision Map Act. However, the Vacation Ownership and Time-Share Act of 2004 may be applicable. Because of this, usually no new map is required by local government regardless of the type (use or estate) of time-share plan.

If the developer is creating an underlying project in California, such as a standard lot subdivision or a common interest development as defined in the Davis-Stirling Common Interest Development Act, simultaneously with the time-share project, he would be required to comply with the Subdivision Map Act for this underlying subdivision.

If the time-share plan is located out-of-state, the subdivision may be subject to local jurisdictional requirements comparable to California’s Subdivision Map Act. The reviewing Deputy should ask for a copy of the recorded map and all applicable maps enumerated below. The maps should be reviewed carefully because different states and localities often have standards for map approvals that are much different from that of California. If the developer states that there is no subdivision map requirement for that jurisdiction the Deputy should request authoritative support for such an assertion from the appropriate government agency, an attorney’s opinion letter or copy of the subdivision laws for that jurisdiction.

The Deputy should ask for a copy of the situs state’s subdivision laws in any event as it may become important in evaluating compliance with California regulatory standards.

### **Maps to be Submitted**

- **Recorded Map - A copy of the map referenced in the legal description, as shown on the Title Report, must be submitted prior to issuance of the Public Report.**
- **Condominium Plan - If a condominium project is being converted to time-share use, or a condominium project is simultaneously being created, a copy of the recorded condominium plan must be submitted prior to issuance of a Public Report.**

- **Plot Plan - A large scale, legible plot plan (site plan) showing all improvements, including location of recreational amenities and boundaries of future phases, if any. In certain cases, the map itself may serve as a plot plan.**
- **Floor Plan - This is applicable to hotels or motels and should reflect the dimensions for units. Include room number and other pertinent information which appropriately describe the unit layout.**
- **Vicinity Map - The developer should always submit a large scale, legible vicinity map showing the location of approaches to the subdivision and identifying "landmarks" to help locate the subdivision.**

## **DEVELOPER MAINTENANCE AND ASSESSMENT EXPENSE OBLIGATION**

**Reference:** Security for Developer's Obligations as an Owner of Time-Share Interests. (Section 11241)

### **Bond, Letter of Credit, or Cash Deposit**

The security shall not exceed the lesser of 50 percent of the anticipated cost of operation and maintenance of the time-share plan, including the establishment of reserves for replacement and major repair, for an operational period of one year or 100 percent of the assessments attributed to the total amount of the total unsold time-share interests owned by the developer and registered pursuant to the Time-Share Act of 2004.

## **COMMON AREA – COMPLETION AND CONVEYANCE**

Completion and conveyance of the common areas is required by Business and Professions Code Sections 11230(completion) and 11254 (conveyance). Arrangements regarding these two elements must be completed prior to issuance of a Final Public Report. Common area completion and conveyance are separate concepts which need not occur simultaneously and should be processed as distinct requirements by the Deputy. Common areas are either to be owned by the purchasers as tenants in common or in fee by a legal entity such as a homeowners' association or corporation or by a combination of the two ownership forms. The ownership of the common areas will have some effect upon the manner in which the principles of completion and conveyance are processed. Personal property, such as furnishings of the accommodations, should be considered part of the common area improvements when considering completion arrangements. Any provision having to do with assuring completion of common area improvements should also expressly cover financial arrangements under Section 11230 for furnishing of the accommodations and conveying the accommodations to the time-share owners association (see Conveyance of Personal Property on Page 23).

### **Improvements Completed before Public Reports are Issued**

If the applicant presents evidence that all improvements have been completed or will be completed before the Public Report is issued, we need only the assurance that improvements will be conveyed to purchasers or the homeowners' association lien-free. This can be accomplished by insisting upon escrow instructions that prohibit the impound depository from releasing any purchaser's funds from the impound until the time-share interest has been conveyed lien-free to the purchaser or that alternative arrangements for lien-free conveyance of the common area are made in compliance with Section 11244 of the Code.

If the developer completes all improvements before a public report is issued, provides evidence of completion to DRE, and there are no blanket encumbrances, then purchase monies may be disbursed to the developer following the seven-day cancellation period (Section 11243(b) of the Code).

## **Escrow Instructions Clause – Arrangements for a California Time-share Plan**

Escrow instructions containing a clause substantially along the following lines should suffice for this purpose:

"All funds deposited by the purchaser of a time-share interest shall be held in escrow until the project is completed and title free and clear of any blanket encumbrance has been conveyed to the purchaser."

In addition to the above described conditions, escrow shall not close until:

"The expiration of the statutory period for the recordation of all mechanic's lien claims following the recordation of a valid Notice of Completion as defined in Section 3093 of the Civil Code."

## **Mechanic Lien Endorsement – Title Policy**

If the developer has provided that each purchaser of a time-share interest shall receive a policy of title insurance with an endorsement against any possible future liens, a purchaser's funds may be released from impound – without regard to the time for filing of mechanic's lien claims – when the developer is able to convey title to the time-share interest free and clear of any blanket encumbrance of record.

The above procedure constitutes compliance under Sections 11230(b) and 11243(b) either if all development and improvement work will be completed prior to issuance of the Final Public Report or prior to closing of individual sale escrows.

## **Completed Improvements in an Out-of-State Project**

Often, out-of-state jurisdictions do not issue Notices of Completion or any comparable document. Lacking Notices of Completion, evidence of completion may be had by Certificates of Occupancy, statements from licensed architects, a Certificates of Substantial Completion or an inspection by the State Fire Marshal designee or an equivalent public inspection safety inspection agency in the applicable jurisdiction. Photographs are not to be construed as satisfactory evidence of completion although they may be considered as supporting the documentation mentioned above. It may require the Deputy with the assistance of the Managing Deputy Commissioner III and Legal counsel to review applicable subdivision laws from the situs state.

## **Improvements not Completed Before a Public Report is Issued**

If all improvements comprising the residential-structure common areas as well as the improvements to the separate or outside common areas, will not be completed prior to the issuance of a Public Report, the developer must comply with Sections 11230 and 11243(b) of the Business and Professions Code.

## **Compliance with Section 11230(a)**

If the developer elects (a), the bond or other financial arrangement must be in an amount sufficient to cover the completion of the residential-structure common area and the outside common areas within the subdivision for which the Public Report is to be issued. Personal property should also be considered.

## **Compliance with Section 11230(b)**

If the developer elects to assure completion through compliance with (b), appropriate instructions to the impound depository shall be required. See the *Escrow Instructions Clauses* section above for the appropriate escrow instruction language. That language may not be functional for some out-of-state projects, so alternative language will need to be evaluated for purposes of compliance with the statute.

### **Compliance with Section 11230(d)**

DRE may approve an alternative plan for completion such as a procedure akin to the “RE 621” procedure that gives the developer the flexibility of switching from escrow instructions (which prevent the closing of escrows until the total project has been completed and is free of all liens), to a bond under Section 11230(a) to assure completion without obtaining an amended public report. After the final public report is issued, the RE 621 provides that escrows cannot close until the common area improvements are completed free and clear of encumbrances or until a bond, along with a planned construction statement and a RE 621A are deposited in escrow. The bond and attendant documents should guarantee completion of the common area and facilities that remain incomplete as of the date of submittal of the RE 621A security and the planned construction statement to DRE. If the time-share property is located outside California, the RE 621 may need to be tailored to accommodate the laws of the situs state. The Deputy should review the document to ascertain that the alternative document to the RE 621 is adequate.

### **Owners’ Association or Trustee**

In some cases, the developer may be able to convey the common area and facilities to the owners’ association or, when required, a trustee, free of any blanket encumbrances prior to the issuance of the Public Report. When title to common areas and facilities is held by an owners’ association or trustee, no problems are encountered as the number of owners of time-share interests’ increases or decreases. This consideration is particularly important with respect to the phased development of time-share plans.

In these cases, care should be taken to eliminate the possibility that mechanic’s lien claims will be filed against common areas after conveyance to the owners’ association or trustee. This can be accomplished by:

- (1) delaying issuance of the Public Report until expiration of the statutory period for filing of lien claims after the recordation of a Notice of Completion (60-days); or
- (2) the issuance of a policy of title insurance to the owners’ association or trustee with an endorsement against unrecorded liens.

If the time-share plan is not in California, different arrangements may be necessary to accomplish this purpose.

### **Purchasers as Tenants in Common**

The developer may convey some or all of the common area to purchasers as tenants in common rather than to an owners’ association. If the unit being time-shared is a condominium, it is necessary to convey at least some of the common area to purchasers as tenants in common, rather than to an owners’ association, in order to qualify as a statutory California condominium under the definition of Section 783 of the Civil Code or, most likely, in order to qualify a time-share condominium located in another state as a statutory condominium under that state’s condominium statutes. It may be necessary to review the situs state’s condominium statutes if necessary.

### **Variations**

There is nothing, however, that demands that common areas and facilities be conveyed to the purchasers as tenants in common or deeded to a homeowners’ association. In fact, either method or a combination of methods may be used.

### **Examples:**

- (1) A condominium offering could provide:
  - A separate interest in space;
  - An undivided interest in common in the residential structure; and
  - Conveyance of common areas and facilities other than the residential structure to the association.
  
- (2) An apartment house or hotel conversion could provide:
  - Undivided interests in common to the entire project.

### **Conveyance to Trustee**

There may be a few instances where development in the common areas included in the offering, i.e., advertised from the beginning, is so extensive that the developer cannot reasonably be expected to complete the improvement work for several months or years after the issuance of the original Public Report. In these cases, the common areas and facilities should be bonded for lien-free completion and should be conveyed to a trustee approved by the Commissioner with the property held in trust for the benefit of the owners' association and the members thereof. As a general rule of thumb, the trust must be irrevocable and must provide for the conveyance of the common areas and facilities, free and clear of encumbrance, to the homeowners' association. (Code Section 11254)

### **Private Facilities Included in the Offering**

Time-share offerings are often associated with hotel resorts with private recreational or other supporting facilities where the sponsor desires to make the recreational or other supporting facilities available to the time-share owners, but retain fee title to said facilities. This arrangement can be accomplished by conveyance of an easement or license to the time-share association. The Deputy should refer to the guidelines for private facilities. The use of a license or easement arrangement should be limited to supporting facilities.

## **ASSESSMENTS PAYABLE BY OWNERS OF TIME-SHARE PROJECT INTERESTS – SECTION 11265**

Section 11265 requires that all interests in a time-share plan for which a Public Report has been issued are interests subject to the payment of regular and special assessments. The Deputy should determine from the form RE 668A how many of the projected interests are to be offered for sale under authority of the Public Report as a preliminary step to reviewing the file documents.

All accommodations in a time-share plan that are to be dedicated to timesharing and to be covered by a Public Report must be subject to assessments.

### **Declaration of Dedication, Importance of**

The Deputy should read the Restrictions (often called Declaration of Dedication, Declaration of CC&Rs, etc.) that relates to assessment obligations and procedures. Many form RE 668A and RE 668B applications state that the Public Report is to cover all of the potential interests in the resort, but the proposed Restrictions may state that Declarant, for each time-share interest owned and each purchaser, for each such interest owned, covenant to pay assessments. It is crucial to locate in the Restrictions the definition of a time-share interest since usually only interests in some of the accommodations or units are designated as such. The remaining accommodations or units are normally designated as non-dedicated. The improper result is that the sponsor is only obligated by the document to pay assessments on unsold interests in time-share interest units and does not pay assessments on interests in accommodations or units not dedicated to time-sharing.

A good method for avoiding this problem is to require the sponsor to covenant in the assessment article to pay assessments on "x" interests ("x" = the interests to be covered by the Public Report) less interests sold to purchasers.

## **BUDGET REVIEW**

The deputy must obtain a current budget certification from the developer. An independent budget review/acceptance from the DRE Budget Review Unit pursuant to Section 11240(g) and Regulation 2807.4 may also be necessary if the budget certification does not meet the standards set forth in Section 11240(f).

Pursuant to 11240(f), the Commissioner may accept a certification from the following without DRE budget review: (1) an independent public accountant, (2) a certified public accountant, who is an employee of the developer, or (3) at the discretion of the Commissioner, another qualified individual or entity. Form RE699D has been developed to grant approval of such qualified individual or entity to prepare and certify time-share budgets.

The following "Budget Review" information, in part, covers areas commonly reviewed by the Budget Review Unit (BRU). This information is not-intended to apply to budgets certified pursuant to Section 11240(f):

### **Category I: "Scope of the Offering"**

The RE 668A, RE 668B, or RE 635C is reviewed to determine the following: whether the project is a single-site or multi-site, in-state or out-of-state (country), units covered, type of units, intervals or points, club concept, use versus fee, number of interests covered, mixed use, inventory, existing association, completion arrangements, third-party contractual obligations, subsidy arrangement, and management obligation. Finally, depending on whether it exists or is to be built, whether utilities are available or to be charged to the association.

### **Category II: "Site Inspection"**

Ordinarily, if it is an in-state project, an on-site inspection is scheduled. The reviewer determines when and how the inspection is done. The inspection could be done before or after an in-house desk review is completed; however, in either case, the initial review should incorporate the on-site inspection findings.

An on-site inspection is performed in the same manner as a common interest subdivision, with the exception that the unit interiors are inspected, as well as shared use facilities. Particular attention is paid to projects that have a mixed use because of the potential of over burdening the association through cost sharing. For example, a converted hotel with dedicated units, when inspected, may indicate that hotel usage far exceeds the proportionate costs placed on the association and contractual obligation arising from the shared use favors the commercial area, as opposed to the association.

### **Category III: "Budget Analysis"**

The initial budget review follows the same procedure as a regular common interest development project (RE 623). However, because the association's obligation extends into the interior of the units, particular attention is placed on the project's inventory (i.e. furnishing contracts, inventory-per-unit, interior construction, etc.). Further, shared use is reviewed (e.g. dedicated units versus others) and its contractual obligations. Also, many projects are multi-tiered and may involve three or more associations maintaining/sharing costs.

An existing project requires additional review procedures, although similar to all common interest reviews. For example, a financial review is conducted, which includes the association's financial status, adequacy of the reserves, and inventory (points or interests).

Under either situation, the proposed budget or the adopted budget is reviewed "item-by-item" to ensure that the charges are reasonable and verified by actual contractual obligations (or proposed contracts). In addition, the contracts are reviewed to ensure that the provisions that impact the association are reasonable, not subject to the sponsor's exclusive control, and in compliance with the appropriate regulations.

#### **Category IV: "Contractual Obligation with the Declarations"**

A review of any contractual obligation (e.g. management contract, deficit subsidy agreement, shared costs, lease arrangement, telephone agreements, reservation agreements, etc.) usually is done in tandem with the budget (RE 623) review. In addition, the Declaration sections that cover the association's obligations and the sponsor's obligations are reviewed to ensure that budget concerns are adequately addressed. This would include rental provisions with association reimbursements, timeframe for rental use, and compliance with the appropriate regulations.

#### **Category V: "Security Arrangements"**

There would be several areas that may require some form of financial security arrangement, all of which are reviewed by the Budget Review Unit. For example, completion arrangements (may require a site inspection); deficit subsidy agreement (done with the budget review); cash-down subsidy arrangement (done with the budgets); shared cost agreement (done with the budget); fiduciary obligations and any other type of agreement that the sponsor promises to perform.

#### **Recap and Problem Watch List**

In general, due to the nature of a time-share project (i.e. highly technical, extremely numbers orientated, and the fact that the sponsor contracts to manage), it usually requires a case-by-case analysis. For example, points conversion and allocation of assessments-to-points, etc. are additional areas of concern. Granted, as indicated above, the approach and procedure are not unlike a common interest subdivision; however, it is the "bundle of obligations" that may impact the association that a reviewer should be most concerned with when reviewing a time-share project.

The following is a watch list of issues relative to a time-share project of which the Budget Review Unit should be aware. Most items simply warrant special note language in the public report:

- (1) Designating units as "live-in quarters" or "sales office" to benefit the marketing program without implementing cost sharing agreement.
- (2) Failure to provide financial accountability.
- (3) Failure to conduct foreclosure sales pursuant to the Declarations (notice and open to the public).
- (4) Failure to provide reimbursement to the association pursuant to the foreclosure sale (delinquent assessments and costs).
- (5) Failure to provide the defaulted interest's owner with the balance of the foreclosure sales proceeds (above and beyond association amounts).
- (6) Failure to provide complete financials. (expenditure, income, year-to-date and profit and loss statements).



- (7) Failure to maintain financial records pursuant to the management agreement and the Declarations.
- (8) Submitted inaccurate DRE forms (failing to notify of changes).
- (9) Securing unauthorized association expenditures contrary to the Declarations (i.e. car lease, maintenance, fees).
- (10) Payments to third-party service providers without appropriate contracts (maid and maintenance service).
- (11) Charging the association with personal costs (insurance and property tax for adjoining property).
- (12) Assumption of association foreclosed interests.
- (13) Revising DRE-reviewed documents and agreements, such as management contracts, without notice and subsequent review by the DRE.
- (14) Expenditure of association reserve funds for non-reserve items. While typically permitted under the legal documents, a special note should be considered.
- (15) Expenditure of association funds to enhance the sponsor's interests (maid's unit, golf membership and camping club).
- (16) Inadequate records of association meetings and voting irregularities (proxy person not in attendance).
- (17) Failure to establish association operating and reserve accounts.
- (18) Failure to secure fidelity insurance or bonds in compliance with Section 11267(a)(9)
- (19) Failure to secure errors and omissions insurance coverage for the managing entity
- (20) Commingled association funds with personal funds.
- (21) Failure to establish contractual obligations with third-parties pursuant to the Declarations and the Regulations (car lease, soda machine, washer and dryer).
- (22) Receipt of management fees in excess of contractual limitations.
- (23) Charging the association for services that were not provided (accounting, audits).

### **Vacant Unit Budgets**

By analogy to the "vacant lot" budgets permitted under Regulation 2792.16(c) for other types of common interest subdivisions, as a matter of policy, it is permissible for the time-share Restrictions to exempt the developer of a time-share project from the payment of that portion of any assessment which is for the purpose of defraying expenses and reserves directly attributable to the existence and use of units which are part of the project (units subject to the time-share Restrictions) but not built, or if built, not renovated or otherwise subject to occupancy.

### **Desk Clerk Expense**

The budgeted management expense may include the services of a desk clerk, who has the duty to check in and out time-share owners. Given that the non-completed or non-renovated units are not subject to occupancy, the desk clerk's salary should be allocable for payment solely to time-share purchasers, and not to the developer. If the developer is not prohibited from renting non-completed or non-renovated units, the developer should not be exempt from sharing in the cost of the desk clerk's salary.

### **Developer Allocated Expense**

Some items of expense are more reasonably allocated to the developer for payment. For example, if the developer's renovation or building program causes the common areas to require more frequent recurring maintenance and clean up, the vacant unit budget should allocate the maintenance person's salary disproportionately, with the developer paying more of this expense per interest owned than does a purchaser.

Other items of fixed expenses, such as real property taxes, reasonably would be shared equally by the developer and purchaser per interest.

The final result of summarizing all such expenses as allocable to purchasers or the developer or both will probably be a lesser cost per interest owned to the developer than to the purchaser. Since the developer will realize that these costs accurately reflect its true carrying costs of the units if they were not part of the time-share project, it will be more likely to include all of the contemplated units in the project from the beginning. The temptation to phase will be reduced, thus avoiding mechanic's lien risks inherent in phasing a one-lot project undergoing construction or renovation; and the association will obtain more control over the project and will be better capitalized.

## **SUBSIDIZATION OF ASSOCIATION EXPENSES BY SPONSOR - SECTIONS 11241 AND 11242**

### **Buy Down Subsidy Agreement (Code Section 11242)**

Under a traditional subsidy agreement a developer may elect to decrease, for a specific time, the purchasers' annual assessments by subsidizing or paying to the association in money all or part of the expenses of the association.

Financial arrangements to assure the ability of the developer to perform will always be required pursuant to Business and Professions Code Section 11242. The bond or other assurance should be accompanied by escrow instructions to the bond/assurance holder. The instructions should provide that the security device should not be released or exonerated until escrow holder receives notice from the association that the developer has faithfully performed under the subsidization contract (Code Section 11242.1).

### **Subsidization Contract**

The subsidization contract should be carefully reviewed. It should provide for the monthly payment of the buy down subsidy by the developer to the association. The subsidy sum should be clearly set forth. If the developer intends to render services or supply goods to the association, the contract should specify in detail the methods to be used in valuing the goods and services (Code Section 11242).

If the developer or an affiliated entity is actually supplying goods or services to the association pursuant to the contract, the developer still must pay the agreed value of these goods/services to the association on a monthly basis even though the association will then write the developer a check for such

goods/services out of an association account. The association should at all times be in a position to control the disbursing and accounting for funds to defray costs attributable to operation and maintenance.

Any subsidy contract submitted should assure that the developer contributes to the association a sum allocable to reserves for replacement and major repairs for each unsold interest.

### **Deficit Subsidy Agreements (Code Section 11241)**

The developer may, as an alternative to paying full assessments for unsold interests, enter into a subsidy agreement with the association to pay any shortfalls between expenses incurred and assessments collected from other owners. The subsidy program must include provisions for accumulations for reserves for replacement and major maintenance of the time-share property in accordance with accepted property management practices and the transfer of the reserve fund to the association at the termination of the subsidy program. An expanded explanation regarding the developer's contribution to reserves is found below.

### **Subsidy Payments**

The contract should be scrutinized for any provision which limits the developer's subsidy obligation to the per-interest assessment paid by purchasers. Such provisions are reasonable only if purchasers share equally with the developer any savings under the subsidy program.

The contract should provide that non developer owners shall not be subject to special assessments during the term of the contract with the exception of special assessments for the construction of common area facilities which are both not part of the original offering by the developer and are consented to by the membership of the association.

### **Developer's Contributions to Association Reserves**

The contract should also provide for the developer's contribution to the association's reserves. The agreement should provide that the sponsor pays reserves for each unsold interest in an amount equal to the amount shown in the association budget allocated to reserves for each interest. Certain fixed cost reserves, such as those for roof replacement, should be shared by the developer and other owners of units in the project. However, reserves for replacement of furniture existing only in renovated units is reasonably allocable only to owners of interests in renovated units.

### **Contract Termination Date**

The contract termination date is usually not specific; however, the agreement must contain some type of provision that would activate the termination in order that duration not be indefinite. Normally, it is terminable upon 30 days notice to the association, provided that prior to such termination the developer obtain a Code Section 11241 bond and upon such termination begin payment of full assessments. Occasionally, in the alternative, it terminates upon the sale of 80% of the interests or a date certain, whichever is first. If 80% of the interests are sold, it is not necessary under Section 11241 to obtain a replacement Section 11241 bond for the existing bond to secure the deficit subsidy agreement. In such case, the developer is obligated to pay assessments on the remaining (20%) unsold units, but is no longer required to bond for the obligation. If it terminates before 80% are sold, the agreement must provide for a bond to secure the developers payment of assessments to be substituted for the deficit subsidy bond.

The amount of the deficit subsidy bond may be the lesser 50% of the annual time-share plan budget or 100% of the assessments attributed to the total amount of total unsold time-share interests owned by the developer and covered by a public report.

If the developer has submitted a certified budget in which DRE will not perform a budget review, the Deputy should ask the developer to submit a statement calculating how it arrived at the amount of the deficit subsidy bond submitted and the Deputy should review the statement to determine that the amount of the deficit subsidy bond is consistent based on the time-share plan budget. If the time-share plan budget is reviewed by the DRE Budget Review Unit, the budget reviewer should review the subsidy agreement and the bond amount for adequacy.

### **When This Type of Subsidy Is Not Permitted**

If the time-share units are part of a condominium, planned development or other Common Interest Development, a “Deficit Subsidy” will not be permitted for the master association. This type of subsidy shall only be made available for the time-share association.

### **Deficit Subsidy – Budget Review Considerations (Applicable only if DRE Reviews Budget)**

Since the developer’s obligation under a Deficit Subsidy Agreement (DSA) would have a significant impact on the association’s ability to meet its financial obligation, the Budget Review Unit should review the DSA so that they may add their input over those areas that will affect the association.

It is incumbent upon the Budget Review Unit to determine what method the developer will utilize in order to calculate the deficiency amount. Since it is to the benefit of the developer to apply any source of revenue generated to offset its deficit payment obligation, the only revenue(s) allowable should be limited to assessments and interest. The reasoning is that all other generated revenue should be set aside for the purpose for which it was generated in the first place (i.e. revenue from renting the recreation facility should be earmarked to offset acceleration of its wear-and-tear). Also, the developer’s obligation should not be limited to either line-by-line costs or assessments that should have been collected.

In addition, there should be a provision that covers the association’s obligation to provide monthly accounting with a yearly reconciliation. Both of these requirements will ensure that funds will be available to cover any association obligations and the yearly reconciliation would apprise the association whether its assessments are either too high or too low, based on the amount of subsidy paid by the developer.

Finally, there should be a provision(s) that covers the developer’s security obligation, and whether the DSA should be amended or accepting an amendment with the original attached. For example, both are somewhat linked together for the following reasons. Ordinarily, the security obligation is based on the lesser of 50% of the annual association budget or 100 percent of the assessments attributed to the total amount of unsold timeshare interests; however, should the association elect to change the annual budget it would effect the security amount. As to the amendment to the DSA, it’s not unusual for the developer to submit only the amendment to the DSA, which covers only the provisions being amended. Since projects may extend into 50+ amended filings, it is extremely difficult to determine whether the amendment satisfies the DRE’s current policies or the B&P Code. Therefore, both documents should be physically linked.

### **Public Report Disclosures for Subsidy Programs**

Although the Time-Share Act under Code Section 11234 does not mandate a disclosure regarding a subsidization program, the Deputy should request that the Public Report for any time-share project which incorporates a subsidization program should include appropriate disclosures.

## **ESCROW REQUIREMENTS – SECTIONS 11243 AND 11244**

Section 11243 provides that the developer shall comply with the following escrow requirements:

(a) A developer of a time-share plan shall deposit into an escrow account in an acceptable escrow depository 100 percent of all funds that are received during the purchaser's rescission period. An acceptable escrow depository includes, when qualified to do business in this state, escrow agents licensed by the Commissioner of Corporations, banks, trust companies, savings and loan associations, title insurers, and underwritten title companies. The deposit of these funds shall be evidenced by an executed escrow agreement between the escrow agent and the developer, that shall include provisions that state the following:

(1) Funds may be disbursed to the developer by the escrow agent from the escrow account only after expiration of the purchaser's rescission period and in accordance with the purchase contract, subject to subdivision (b).

(2) If a prospective purchaser properly cancels the purchase contract pursuant to its terms, the funds shall be paid to the prospective purchaser or paid to the developer if the prospective purchaser's funds have been previously refunded by the developer.

(b) If a developer contracts to sell a time-share interest and the construction of any property in which the time-share interest is located has not been completed, the developer, upon expiration of the rescission period, shall continue to maintain in an escrow account all funds received by or on behalf of the developer from the prospective purchaser under his or her purchase contract. The commissioner shall establish, by regulation, the types of documentation which shall be required for evidence of completion, including, but not limited to, a certificate of occupancy, a certificate of substantial completion, or an inspection by the State Fire Marshal designee or an equivalent public safety inspection agency in the applicable jurisdiction. Unless the developer submits financial assurances, in accordance with subdivision (c), funds shall not be released from escrow until a certificate of occupancy, or its equivalent, has been obtained and the rescission period has passed, and the time-share interest can be transferred free and clear of blanket encumbrances, including mechanics' liens. Funds to be released from escrow shall be released as follows:

(1) If a prospective purchaser properly cancels the purchase contract pursuant to its terms, the funds shall be paid to the prospective purchaser or paid to the developer if the prospective purchaser's funds have been previously refunded by the developer.

(2) If a prospective purchaser defaults in the performance of the prospective purchaser's obligations under the purchase contract, the funds shall be paid to the developer.

(3) If the funds of a prospective purchaser have not been previously disbursed in accordance with the provisions of this subdivision, they may be disbursed to the developer by the escrow agent upon the issuance of acceptable evidence of completion of construction.

(c) In lieu of the provisions in subdivisions (a) and (b), the commissioner may accept from the developer a surety bond, escrow bond, irrevocable letter of credit, or other financial assurance or arrangement acceptable to the commissioner. Any acceptable financial assurance shall be in an amount equal to or in excess of the lesser of (1) the funds that would otherwise be placed in escrow, or (2) in an amount equal to the cost to complete the incomplete property in which the time-share interest is located. However, in no event shall the amount be less than the amount of funds that would otherwise be placed in escrow pursuant to paragraph (1) of subdivision (a).

(d) The developer shall provide escrow account information to the commissioner and shall execute in writing an authorization consenting to an audit or examination of the account by the commissioner on forms provided by the commissioner. The developer shall comply with the reconciliation and records requirements established by regulation by the commissioner. The developer shall make documents related to the escrow account or escrow obligation available to the commissioner upon the department's request. The escrow agent shall maintain any disputed funds in the escrow account until either of the following occurs:

- (1) Receipt of written direction agreed to by signature of all parties.
- (2) Deposit of the funds with a court of competent jurisdiction in which a civil action regarding the funds has been filed.

Section 11244 further defines escrow and purchase money handling as follows:

(a) Excluding any encumbrance placed against the purchaser's time-share interest securing the purchaser's payment of purchase money financing for the purchase, the developer shall not be entitled to the release of any funds escrowed under Section 11243 with respect to each time-share interest and any other property or rights to property appurtenant to the time-share interest, including any amenities represented to the purchaser as being part of the time-share plan, until the developer has provided satisfactory evidence to the commissioner of one of the following:

(1) The time-share interest, including, but not limited to, a time-share interest in any component sites of a nonspecific time-share interest multisite time-share plan, together with any other property or rights to property appurtenant to the time-share interest, including any amenities represented to the purchaser as being part of the time-share plan, are free and clear of any of the claims of the developer, any owner of the underlying fee, a mortgagee, judgment creditor, or other lienor, or any other person having an interest in or lien or encumbrance against the time-share interest or appurtenant property or property rights.

(2) The developer, any owner of the underlying fee, a mortgagee, judgment creditor, or other lienor, or any other person having an interest in or lien or encumbrance against the time-share interest or appurtenant property or property rights, including any amenities represented to the purchaser as being part of the time-share plan, has recorded a subordination and notice to creditors document in the appropriate public records of the jurisdiction in which the time-share interest is located. The subordination document shall expressly and effectively provide that the interest holder's right, lien, or encumbrance shall not adversely affect, and shall be subordinate to, the rights of the owners of the time-share interests in the time-share plan regardless of the date of purchase, from and after the effective date of the subordination document.

(3) The developer, any owner of the underlying fee, a mortgagee, judgment creditor, or other lienor, or any other person having an interest in or lien or encumbrance against the time-share interest or appurtenant property or property rights, including any amenities represented to the purchaser as being part of the time-share plan, has transferred the subject accommodations, amenities, or all use rights in the amenities to a nonprofit organization or owners' association to be held for the use and benefit of the owners of the time-share plan, which shall act as a fiduciary to the purchasers, the developer has transferred control of the entity to the owners or does not exercise its voting rights in the entity with respect to the subject accommodations or amenities. Prior to the transfer, any lien or other encumbrance against the accommodation or facility shall be made subject to a subordination and notice to creditors' instrument pursuant to paragraph (2).

(4) Alternative arrangements have been made which are adequate to protect the rights of the purchasers of the time-share interests and approved by the commissioner.

(b) Nothing in this section shall prevent a developer from accessing any escrow funds if the developer has complied with subdivision (c) of Section 11243.

(c) The developer shall notify the commissioner of the extent to which an accommodation may become subject to a tax or other lien arising out of claims against other purchasers in the same time-share plan. The commissioner may require the developer to notify a prospective purchaser of any such potential tax or lien that would materially and adversely affect the prospective purchaser.

## **Acceptable Escrow Depositories**

The escrow depository for the sale of multi-site time-share project interests must be an acceptable California escrow company pursuant to Regulation 2807.2.

An out-of-state escrow depository may be used provided that a California affiliate is willing to stand in the shoes of the out-of-state affiliate with regard to purchase money protections for California purchasers. Most title/escrow companies active in timeshares process their escrow through a central, national timeshare division.

## **PERSONAL PROPERTY**

Personal property may include furniture, appliances, window treatments, floor treatments, linen package, dishes and utensils, boats, automobiles, skis and other properties exclusive of buildings and grounds. The personal property should be considered common area and regulated under Section 11230. The personal property may be conveyed or leased to the association or conveyed by fractional interests to the interest owners. Such property may also be conveyed to an acceptable trustee whose duty would be to retain title to the property for benefit of the interest owners and to protect the property against third party claims.

### **Conveyance of Personal Property**

There should be provisions for assuring purchasers receiving use of personal property prior to issuance of the Public Report or prior to close of the first escrow with appropriate assurances of conveyance or other adequate means of assuring use, free of liens and encumbrances. Adequate financial arrangements for purchase and placement of the property in the project must be provided in compliance with Section 11230. Personal property can be leased or financed provided there is adequate non-disturbance language stating that so long as the association is current in the lease/loan payments, the lessor/lender shall not repossess the personal property, regardless of whether the developer is in default under any loan covenants with the lessor/lender.

### **Personal Property Conveyed Outright to an Association**

When personal property is conveyed outright to the association, the event is effected by a bill of sale. The escrow instructions should include a provision requiring delivery of the bill of sale which includes, as an exhibit, the inventory of personal property, to the association prior to the close of escrow of the first sale. In order that escrow can verify that the inventory attached to the bill of sale is correct, a proper inventory should be attached to the escrow instructions and referred therein. The escrow must also state that the personal property will be delivered to the association and the personal property placed in the dedicated units or appropriate location for use prior to close of escrow.

### **Personal Property Leased to an Association**

In all cases the Subdivisions Deputy or the Budget Review Deputy, if there is a budget review, should be certain that lease payments are properly included in the association budget. The escrow instructions should include a provision which requires delivery of the lease to the association and the installation of the leased property to the project prior to closing of the first escrow. Unless financially secured, personal property shall be installed prior to the first close of escrow.

### **Free and Clear Conveyance of Personal Property**

To insure free and clear conveyance of the personal property, the escrow instructions should include a provision which requires that prior to close of escrow, a U.C.C.-3 Form will be issued by the Secretary of State to the association indicating that there are no financing statements on file naming the developer

and/or lessor. A financing statement (U.C.C.-1) is a document filed with the Secretary of State by a creditor declaring security interests against an individual or entity for specific types or items of property.

If such a proposal is made, the sponsor should provide written support for the arrangement, which includes the reasons for not proposing to convey the personal property outright to the association. The Deputy should disapprove the arrangement if the developer fails to demonstrate that, pursuant to Section 11229(b)(5), that it has failed to make a showing that the parcel can be used for the purpose for which offered by failing to demonstrate that purchasers will have assured of the personal property.

## **RENTAL OF UNITS - SECTION 11245(b)**

For any time-share plan in which the managing entity is an affiliate of the developer, neither the developer nor the managing entity shall, during any applicable priority reservation period, hold out for rental to the public on a given day, developer owned or controlled time-share periods in a number greater than the total number of time-share periods owned or controlled by the developer in a particular season, multiplied by a fraction wherein the numerator is the number of time-share periods owned or controlled by the developer in that particular season, and the denominator is the total number of time-share periods in that particular season. For example, if the developer owns or controls 1,000 time-share periods in a particular season, out of a total of 4,000 time-share periods available during that season, then the developer may not hold out for rental to the public during any applicable priority reservation period, more than 250 time-share periods on a given day during that season ( $1,000 \times 1,000/4,000=250$ ). The number of time-share interests permitted to be rented under this subdivision shall be in addition to any time-share interests that the developer may have the right to rent or use by virtue of having acquired those rights from another owner. The developer or managing entity may, at any time, rent any inventory transferred to the developer or managing entity by another owner in exchange for hotel accommodations, future use rights, or other considerations. For any use or rental by a developer of time-share interests owned or controlled by the developer, the developer shall reimburse the association for any increased expenses for housekeeping services that exceed the amount allocated in the assessment for maintenance for the use or rental.

## **MANAGEMENT AGREEMENT (CODE SECTION 11267)**

The time-share instruments (Bylaws or Declaration of Dedication) shall require the employment of a managing entity for the time-share plan or component site pursuant to a written management agreement.

The management agreement shall include the provisions enumerated in Code Section 11267. Sometimes, the developer recites the required provisions of the management agreement in the Declaration. While this is not objectionable, it does not excuse the requirement for submission of a copy of the executed management agreement between the association and selected managing agent prior to issuance of the Public Report (Regulations 2809.1 and 2809.3).

### **Compensation to Manager**

Usually management agreements provide for compensation of the managing agent to be measured by a specified percentage of the maintenance and operation expenses.



## **Error by Managing Agent and/or Monetary Compensation to Damaged Owner. [Section 11251(c)(7)]**

If, due to the error or negligence of the association or the managing agent, a dwelling unit cannot be made available for the period of use to which an owner is entitled by schedule or under a reservation system, the association is obligated to provide such owner with compensating use periods or money. This duty should be set forth in the Declaration.

## **FIDELITY BOND – SECTION 11267(a)(9)**

The time-share instruments shall require the employment of a managing entity for the time-share plan or component site pursuant to a written management agreement that shall include the following provisions:

A requirement that the managing entity provide a policy for fidelity insurance or bond for the activities of the managing entity, payable to the association, which shall be in an amount no less than the sum of the largest amount of funds expected to be held or controlled by the managing entity at any time during the year, pursuant to the budget. The commissioner may provide a reduction in the insurance policy or bond amounts required by this paragraph.

## **MIXED COMMERCIAL AND TIME-SHARE PROJECT**

Dwelling units to be dedicated to time-sharing use may be situated within a facility which includes dwelling units which will be utilized as rentals and/or a restaurant, bar, stores or other commercial establishments.

When the project is a time-share estate offering in which the project includes commercial establishments, it is necessary to determine whether those establishments will become conveyed to time-share interest owners or the association. The developer may attempt to retain ownership of these businesses under the theory that ownership of such profit-making enterprises by a non-profit incorporated association would constitute a security requiring registration with the Department of Corporations. The fact that a time-share estate purchaser may derive a pro rata monetary benefit from rental payments by the lessee of a commercial adjunct to the time-share project probably does not create a security out of the time-share estate being sold. Unless an investment contract is offered in the sale, it is doubtful that ownership of a business by an association of interest owners would constitute a security if the income to the association is incidental.

If qualification of the project with the Department of Corporations or the SEC is necessary, a Public Report must not be issued without evidence of a prospectus from the Department of Corporations/SEC, or a written opinion of counsel or a written statement from the Department of Corporations that the project does not require registration. If the project is still in the planning stages, you should implore the sponsor to segregate the commercial facilities and the property containing the time-share dwelling units through a lot split or other means.

If the developer is unable to facilitate such a lot split, and the time-share interest owners (or the HOA) will have a proprietary interest in the commercial facility, it would normally be considered reasonable for the association to operate the business if the profits are nominal as there would be no securities issued.

If however, the developer presents evidence from the Department of Corporations or the SEC stating that this type of an offering would be considered a security or if the non-profit status of the association would be jeopardized in operating such an enterprise, alternative arrangements for operation of the business should be made. For example, provisions may be made within the management documents to

prohibit the association from engaging in such activities. Other than such a prohibition, the only other reasonable alternative would be a long-term agreement (i.e., lease) between the association and a third party so that the latter would be obligated to maintain and operate the facility. This type of agreement must not benefit the commercial operator to the detriment of the association. It must be remembered that this is property owned, directly or indirectly, by time-share interest owners; thence, some of the benefits derived from the commercial operation should inure to the owners. The primary benefit to the owners would be rent paid by the operator to the association which would be used to defer a portion of the association's operating expenses. As long as the amount of the rent is "nominal" (for example, \$1.00 per time-share interest per month), and is utilized exclusively to offset costs, the Department of Corporations probably would not question the association's non-profit status. As with any dwelling unit that has not been dedicated to time-share use, the reviewing Deputy should ascertain whether the operator is properly obligated to maintain the interior of the facility and to pay, to the association, its proportionate share of monies (apart from the rent described above) in order to maintain the common or public areas. This type of an agreement should be reviewed by both a staff attorney in addition to the Deputy.

### **Equitable Allocation of Operating Costs**

In a project wherein there are commercial units and/or other commercial facilities that share the use of common areas or facilities with the time-share unit owners, the Declaration of Dedication must provide for provisions for equitable allocation between the time-share project and the commercial operation of costs of management and operation incurred for the joint benefit of the time-share project and the commercial facility. The developer must covenant, through the Declaration of Dedication, to allocate such costs by a mechanism as required by Section 11251(a)(12) of the Business & Professions Code.

If the time-share budget is not reviewable by DRE, the Deputy should confirm that the certified time-share budget includes provisions for sharing costs between the commercial owners/operators and the timeshare owners. If the budget is reviewed by the DRE Budget Review Section, the adequacy of the procedures for allocating costs, including the expense allocations will normally be evaluated by the Budget Review Deputy. If the DRE Budget Review Section is reviewing the budget, the following are essential ingredients of the allocation schedule:

### **Square Footage Allocation Method**

The allocation of expenses is typically based on the square footage of the commercial facilities in relation to the total project. Alternative methods of allocating expenses should be considered provided such allocation is fair and reasonable.

### **Property Taxes – Commercial Property**

The developer must pay the property taxes for the commercial property. If the tax bill for the entire property is delivered to the association, the developer must agree to pay his proportionate share for the commercial facility. The agreement should spell out the developer's liability for increase in the property taxes due to the existence of the commercial facility.

### **Utilities and Services**

The developer must be responsible for all costs of utilities and services to the commercial facility or the undedicated dwelling units.

### **Liability Insurance**

The developer *must* obtain a policy of liability insurance insuring the association against any liability arising out of ownership, use or occupancy due to personal injuries or death. A policy of hazard insurance in amount equal to at least 80% of the full replacement value of the structures should be obtained in which the association should be named as an additional insured.

## **Separate Book and Records – Commercial**

There must be provisions requiring separate books and records for the commercial operation.

## **Reciprocal Easements**

The Declaration must include provisions for reciprocal easements between time-share units and commercial facilities if the nature of the project deems cross-use rights necessary.

It is important that the Deputy observe, if the time-share plan property is an out-of-state property, the provisions of Section 11251(b), which provides that if there is a conflict with the requirements of the requirements set forth in Section 11251 and the provisions of the laws of the situs state, the laws of the situs state shall control. That means that DRE cannot compel the developer to change the provisions of the Declaration in this instance.

## **CONTRACTS AND LIQUIDATED DAMAGES**

### **Contracts**

Section 11256 defines specific terms required to be included in the contracts used by a developer in the sale of time-share interests, including prompt return of purchase money to a non-defaulting buyer, and allowable purchase money disbursements.

Contracts for the sale of time-share plan interests that contain provisions for liquidated damages due to default by purchaser must also contain provisions that comply with Section 11256.

### **Anti-Deficiency Judgment**

The Department has taken the position that the anti-deficiency judgment provisions of the Code of Civil Procedure, Section 580(b), are applicable to sales of time-share interests. Each such contract or financing instrument should contain a statement where the subdivider declares he will not seek a deficiency judgment in the event of a default by a purchaser.

## **RESCISSION RIGHTS**

In accordance with the provisions of Section 11238 of the Business and Professions Code, a purchaser of a time-share interest, incidental benefit or any right under an exchange program has the right to cancel the purchase contract if person who has made an offer to purchase a time-share interest shall have the right to rescind any contract resulting from the acceptance of the offer within seven calendar days after the receipt of the public report or the execution of the purchase contract, whichever is later.

### **Rescission Rights Notice**

To inform a person of his or her right to cancellation, the developer shall attach to the face page of every copy of a Subdivision Public Report given to a prospective purchaser the notice as set forth in Code Section 11239. In addition, a "special note" describing these rescission rights is to be shown on every Public Report where the subdivision is a time-share plan. See form RE 615 for the language which is to constitute the "special note."

The contract for the purchase of a time-share interest must also include immediately prior to the space reserved for the purchaser's signature, a disclosure, in conspicuous type, a notice of cancellation as prescribed in Code Section 11238(d)(7).

### **HUD/Interstate Land Jurisdiction**

If the project is subject to HUD/Interstate Land jurisdiction, the Public Report should include any extra rescission rights that are provided by federal law.

### **Out-of-State Projects**

In the case of out-of-state projects, the California cancellation rights will apply regardless of any rights of cancellation in effect where the project is located.

## **TRUSTS – SECTIONS 11254, 11255 AND REGULATION 2807.3**

Section 11254 requires that title to each accommodation in any time-share use plan and in those time-share estate plans that are subject to monetary encumbrances be conveyed to a trustee or an association. (See comments under *Subordination* for exceptions.)

Any time dwelling units in a time-share project are conveyed to a trustee under a trust agreement, the Deputy must ensure compliance with all provisions of Sections 11254 and 11255.

### **Trust Agreement**

In a typical time-share trust agreement, the developer is the trustor, a bank is the trustee, the holders of the underlying encumbrances are the primary beneficiaries; the developer is the secondary beneficiary, and the owners' association is a third party beneficiary if not a party.

### **Trust for Time-Share Use Projects**

When the property is a time-share use project that is not subject to blanket encumbrances, the trust is essentially a passive one, and must include the provisions listed in Section 11255(d).

### **DRE Legal Review**

All trust agreements in time-share projects are to be reviewed by the Department's Legal staff. The Deputy assigned to the file must also review the trust. Particular attention should be paid to the following provisions when and/or if required to be part of the trust:

### **Transfer Prior to Close of Escrow**

All property to be conveyed to a trustee must be transferred to the trust prior to the closing of the escrow for the first sale of a time-share interest in the accommodation in accordance with Sections 11254 and 11255.

Whenever title is to be transferred to a trustee pursuant to Sections 11254 and/or 11255, evidence of the conveyance must be submitted as part of the filing prior to issuance of a Final Public Report.

### **Termination of Trust**

A trust for a time-share use plan may not terminate before the termination of all of the use rights; a time-share estate trust may terminate at any time after the blanket monetary encumbrances have been paid off.

### **Deposits to Trust**

Ensure the provisions of the trust instrument clearly spell out the requirements and the procedures for insuring that adequate funds, contracts and/or promissory notes are deposited into the trust by the developer as funds are disbursed or notes and contracts paid off.

## **Acceptable Trustees**

Refer to Section 11255 and Regulation 2807.3 for acceptable trustees.

## **SUBORDINATION**

If a time-share interest is subject to a blanket encumbrance, the developer may not release purchase monies escrowed under Code Section 11243 until, in compliance with Code Section 11244(a), the timeshare interest, including a time-share interest in any component sites of a nonspecific time-share interest multisite timeshare plan, or any other property or rights to property appurtenant to the time-share interest, including amenities that are represented as part of the time-share plan are free and clear of any of the claims of the developer, any owner of the underlying fee, a mortgagee, judgment creditor, or other lienor, or any other person having an interest in or lien or encumbrance against the time-share interest or appurtenant property or property rights.

If the property in which the time-share interest is appurtenant to, or property rights, or any amenities represented as being part of the time-share plan, are subject to a blanket encumbrance, purchase monies may be released from escrow if , in accordance with Code Section 11244(a)(2), subordination is recorded that provides that the lien-holder's right, lien or encumbrance shall not adversely affect, and shall be subordinate to the time-share interests.

Alternatively, purchase monies may be released from escrow under Code Section 11244(a)(3), if the developer, owner of the underlying fee, or any person having an interest in a blanket lien or encumbrance against the time-share interest or appurtenant property or property rights, including represented amenities, has transferred the accommodations, amenities or all use rights to the amenities to a nonprofit organization or association to be held for the use and benefit of time-share interest owners, to act as fiduciary to the purchasers. The developer must either transfer control of the entity to the owners or there must be provisions prohibiting the developer from exercising its voting rights in the entity with respect to the property or amenities. Prior to transfer, subordination must be made as required in Code Section 11244(a)(2).

Alternative arrangements for satisfying the provisions of Code Section 11244 may be evaluated by the Deputy to determine if they adequately protect the rights of purchasers.

If the developer has posted a purchase money bond pursuant to Code Section 11243(c), the developer may access purchase monies notwithstanding the provisions of Code Section 11244 as provided in Code Section 11244(b).

If releases from the blanket encumbrance(s) and/or lender subordination are not available, Section 11255(d) provides that each of the accommodations in a time-share estate project that is subject to a blanket encumbrance be conveyed to a trustee acceptable to the Department prior to the closing of the escrow for the first sale of a time-share estate which entitles the purchaser to occupy the unit in question.

## **LOCAL ORDINANCES**

Some local governmental authorities have enacted ordinances that impose restrictions and conditions for compliance prior to permitting the dedication of accommodations to time-sharing.

## **Developer Compliance**

If, in the RE 668A, the developer indicates the local jurisdiction prohibits or has imposed conditions for dedication of accommodations to time-shares, the developer must furnish, in accordance with Code Section 11226(e), a copy of the Permit or other entitlement for time-share use from the local governmental agency prior to issuance of a Public Report. For purpose built time-share projects, the consent of the local authorities can often be found in the conditions of map approval.

## **COASTAL COMMISSION**

The California Coastal Commission, on January 24, 1980, voted unanimously to "assert jurisdiction" over the conversion of hotels and motels in California's Coastal Zone to time-share projects. They have also asserted jurisdiction over the implementation of time-share conversions in other properties, such as condominiums.

The Coastal Commission's position on time-share projects is supported by a 1980 California Court of Appeals decision on *Cal Coastal Commission v. Quantam Investment Corporation* (113cal.ap.3<sup>rd</sup>579) in which an apartment project was being converted to a stock cooperative. Sponsors with projects in the California Coastal Zone fall into one of two categories and must comply as indicated:

- (1) **New Construction** – Submit copy of Permit or Exemption from the Coastal Commission.
- (2) **Conversion** – Submit copy of letter notifying the Coastal Commission of the sponsor's intent to dedicate units to time-sharing.

## **INVENTORY CONTROL**

The Time-share Act of 2004 in Code Section 11250 provides that time-share plans shall maintain a one-to-one purchaser to accommodation ratio, meaning the ratio of the number of purchasers eligible to use the accommodations of a time-share plan on a given night to the number of accommodations available for use within, such that the total number of purchasers eligible to use the accommodations of the time-share plan during a given calendar year never exceeds the total number of accommodations available for use in the time-share plan during that year. Satisfaction of that inventory control requirement is found in the provisions of Code Section 11246. In an application of a public report, whether the application is for an amendment or renewal of a public report or with the initial submittal of an application for a public report, in which the developer agrees to provide title insurance, DRE will require the title insurer to provide a statement to the DRE that it will insure the time-share interests to be conveyed to purchasers as legally described in the grant deed submitted to DRE by the developer and that it will insure the use rights either described in the grant deed(s), declaration of dedication or both.

Certain title companies will monitor the sale of intervals in time-share estate projects and issue DRE acceptable preliminary title reports that define the underlying real property, as well as the unsold time-share intervals. Inventory control for time-share use projects can be more difficult to track without recorded deeds of conveyance for reference.

In the most basic time-share offering where all the intervals are identical, e.g. one week, one room size and one season, an interval identification system could be established simply by sequentially numbering the intervals from one to the total number of intervals in the project. The total number of intervals in the project would equal the number of dwelling units multiplied by the number of weeks. Unfortunately, time-share interval identification systems are rarely as simple as this hypothetical time-share offering.

Most time-share offerings include a variety of different interval types to satisfy different consumer demands.

If the time-share project will include more than one type of interval, such as room size, season, etc., the time-share declaration must clearly define the system of identifying each type of time-share interval to be sold. Typically, this is done by assigning each interval a unique number that is defined in the declaration and listed on the deed or contract given to the purchaser. This will enable the sales to be identified by interval number that can be used in monitoring sales within each type of interval, as well as the total interval sales number.

The developer may propose to control the sales of inventory by listing only the fractional undivided interests in the project on the deed or contract without using an interval number linked to the numbering system defined in the time-share declaration. In a project where different interval types or seasons are being sold, the fractional interest being conveyed for the use of a one bedroom unit may be the same as the fractional interest conveyed for a two or three bedroom unit. Similarly, the fractional interest appurtenant to a premium season may be the same as the fractional interest appurtenant to a low season interval. To allow proper sales monitoring and prevent over selling within a particular unit type or season, it is critical to distinguish between the unit types being sold with unique interval numbers. Often the interval identification number will be comprised of a series of numbers, such as the dwelling unit number, week number, and season designation number.

Inventory control in time-share estate project can be monitored by inspecting the recorded conveyance deeds in the public record, provided the proper interval identification system has been established in the time-share declaration, as discussed above, and properly noted in each deed of conveyance.

For time-share plans in which time-share estate interests will be offered for sale and the developer will not provide title insurance or time-share plans in which time-share use interests will be offered for sale, and time-share interests were sold prior to the issuance of the public report, DRE will require the developer to submit a certification by either a title company or a Certified Public Accountant that the inventory control system, described in Business & Professions Code Section 11226(c),(6), functions in accordance with the description set forth in that section. The certification must be dated not more than three months prior to the submittal of the public report application. Code Section 11246 requires the certification to be based on a random sampling of transactions performed within six months preceding the date of the application.

## **TITLE**

To satisfy the requirements of Section 11229(b)(2) of the Business and Professions Code, time-share Public Report applicants must provide evidence of the ability "...to deliver title or other interest contracted for". Typically, evidence of title for time-share projects is provided in the form of a preliminary title report with the DRE special note, as is provided with other types of subdivisions.

Time-share use offerings require title be protected in trust, as further discussed herein under *Trusts*.

In time-share estate offerings the purchaser receives a right of occupancy in a time-share project which is coupled with an estate in the real property. If the time-share project is divided into equal occupancy rights coupled with equal estates in real property, as in the basic hypothetical example given under *Inventory Control* herein, the purchasers use rights would always be accurately defined by his fractional fee interest in the property. In this example the title evidence required from a Public Report applicant need only to define the applicants undivided fractional fee interest in the real property, because the right of occupancy always equals the estate in real property. The same title evidence requirements would

apply to a points based time-share estate project wherein the purchasers use rights is defined by his undivided fractional fee interest in the property and the fractional fee interest is made up of the number of points purchased, divided by the total number of points in the project.

As explained under *Inventory Control*, time-share estate offerings are often divided into equal estates in real property coupled with unequal rights of occupancy. For example, the purchaser of a one bedroom low season unit may receive the same undivided fractional fee interest in the project as the purchaser of a three bedroom premium season unit. Therefore, it is critical that the title evidence requirement for this type of time-share estate offering include, in addition to the fractional fee interest in the project, an exact definition of all the use rights that are coupled with the fee estate in real property. The title insurance company will provide an additional exhibit to the title report that list the intervals owned by the applicant, provided the interval identification and inventory control system has been adequately defined in the time-share declaration.

## **MULTI-SITE TIME-SHARE PLANS**

Multi-site time-share plans are defined in Business and Professions Code Section 11212(z)(2) as either:

(A) A “specific time-share interest,” which is the right to use accommodations at a specific time-share property, together with use rights in accommodations at one or more other component sites created by or acquired through the time-share plan’s reservation system.

(B) A “non-specific time-share interest,” which is the right to use accommodations at more than one component site created by or acquired through the time-share plan’s reservation system, but including no specific right to use any particular accommodations.

“Specific time-share interest” multi-site time-share plans and “non-specific time-share interest” plans are treated differently in how DRE processes public report applications.

### **“Specific Time-Share Interest” Multi-Site Time-Share Plan Applications**

At the time the initial application is made, a RE 668A must be completed and for only the component site in which the purchaser has a priority right reserve use and occupancy of accommodations at a specific component site on a priority basis. The developer is not required to submit an application for any of the other component sites in the time-share plan.

### **Mandatory Reservation Systems – “Specific Time-Share Interest” Multi-Site Time-Share Plans**

This type of time-share plan is affiliated by means of a contract or membership agreement through a mandatory reservation system with other time-share projects or resorts and time-share purchasers of interests in the specific component site receive, on a priority basis, the use or occupancy of accommodations at that site and it is subject to all the regulatory requirements of a single site time-share plan.

The reservation system documents that are established for the purpose of administering reservations among owners of interests for the component time-share projects or resorts affiliated through the contract or membership agreement are not subject to DRE regulation. However, there must be provisions in those documents for disaffiliation from the reservation system affiliation agreement and for limitation on costs assessed to time-share owners in the specific component site.



Regulations Section 2805.9 expands the definition of “the right to use accommodations at a specific time-share property” used in Section 11212(z)(2)(A) to mean a priority right of not less than sixty days to reserve accommodations at the specific time-share property without competing with owners of time-share interests at other time-share properties that are part of the time-share plan. The document(s) for reserving accommodations at the specific time-share property must include a provision requiring a time period of not less than sixty days during which owners in the specific time-share property may make a reservation prior to the time period in which other persons may make reservations at that site.

### **Public Reports-“Specific Time-Share Interest” Multi-Site Time-Share Plans**

The public report must include all disclosures required for single-site time-share plans as enumerated in Code Section 11234(a) in addition to disclosures described in Code Section 11234(b) designed expressly for “specific time-share interest” in multi-site time-share plans. Code Section 11234(b) include requirements for specific disclosures about each of the component sites, the management entity for the reservations system, the fees payable to the operator of the reservation system by purchasers, among other required disclosures. The developer may include these disclosures in the body of the report or attached to the report as exhibits.

Code Section 11226(g) consists of two matters which require developer certification. The developer is required in the RE 668A to certify that purchasers have contractual or membership rights to use accommodations at all component sites and that, if those component sites are subject to blanket encumbrances, the blanket encumbrances will be subordinate to those rights (Code Section 11226(g)(1). The developer must also certify that a certificate of occupancy has been issued with respect to the accommodations at each affiliated site or that adequate provisions exist for completion of all promised improvements for component site accommodations. Under Code Section 11226(g)(2), for any accommodations for which adequate provisions for completion do not exist, the public report must disclose, in conspicuous type, that the accommodations may not be built, provided that a developer’s failure to build the accommodations shall not relieve the developer of any obligations created by the certification made pursuant to this code section

The disclosure in the Public Report concerning this kind of project should be clear that there are no assurances regarding the ability to reserve accommodations in the component resorts and that there are no assurances that the mandatory reservation system will continue to exist.

### **“Non Specific Time-Share Interest” Multi-Site Time-Share Plan Applications**

RE 668B is required for a *non-specific time-share interests* in a *multi-site time-share plan* as defined in B&P Code Section 11212(z)(2)(B).

A separate RE 668B must be completed and fee paid for each location of a multi-site plan that includes a non-specific time-share interest and which is not currently covered by a California public report.

The RE 668A is not applicable to this type of Time-share Plan. Because the documents for the reservations system and organizational documents for the operation of this type of time-share plan and documents to be utilized for the purchase and marketing of individual interests will be applicable to all component sites, those documents should be submitted with one of the initial RE 668Bs. The file that includes that application will be designated the “Primary” Application, which is similar to a Master File. All other applications for component sites are referred to as “Secondary” applications. The instructions for completing a Primary and Secondary application is included in the instructions and the body of the RE 668B.

## **How a “Specific Time-Share Interest” and “Non-Specific Time-Share Interest” Multi-Site Time-Share Plans Work**

Purchasers of time-share interests in a multi-site time-share plan may be conveyed either a time-share estate or a time-share use. Multi-site time-share plans in which time-share estate interests are conveyed are rare. If the interest conveyed is a time-share estate, the purchaser would receive a deeded interest in one of the component sites. For purposes of his or her rights to use and occupy dwelling units in the multi-site time-share plan, the deeded interest conveyed to that purchaser would have no meaning. That purchaser would not have any superior right to use and occupy dwelling units in the site in which he or she received a deeded interest over and above other owners of interests in the multi-site time-share plan.

“Non Specific Time-Share Interest” multi-site time-share plans more commonly involve the sale of right-to-use interest wherein the terms of the purchase and conveyance are included in the purchase agreement. The purchase agreement will describe the basic nature of the reservation right the purchaser receives. The purchase agreement might state the purchaser has the right to use any unit of a certain type every year or only during a certain time of year. The purchase agreement also may involve the assignment of points, which is another way to determine the value of the reservation rights purchased. The more points one purchases, the greater flexibility that purchaser has in making reservations to use dwelling units in the component sites. Refer to *Time-Share Points Programs* for more information on this topic.

The component sites may include entire subdivisions, selected individual dwelling units in pre-existing time-share projects or in other types of subdivisions or it may be merely involve a few fractional interests in an existing time-share project unrelated to the multi-site time-share project.

There is usually bifurcated management for time-share plans. An “administrative” management agreement, which is a contract between the managing agent and the owners’ association for the multi-site time-share plan, administers the reservation system and performs other duties as established in that contract for the purpose of operating the multi-site time-share plan. Then there is the “on-site” manager, which performs maintenance and operational duties with respect to the individual component sites. On occasion, the management agreement may encompass both administrative and on-site management duties. Any management agreement must be reviewed by the Subdivisions Deputy for compliance with Code Section 11267.

## **Review of Governing Documents**

Each component site’s governing documents should be reviewed carefully for compliance with Code Sections 11233 and 11234 as well as Article 3 and Article 4 of Chapter 2 the Vacation Ownership and Time-Share Act of 2004. Often, multi-site time-share plan governing documents for out-of-state subdivisions are drafted to meet the situs state’s laws and regulations because the project originates in another state. If the component site is located in California and is burdened by an underlying common interest subdivision, a completed RE 648 must be submitted by the sponsor.

If there are provisions of governing documents for either the time-share project documents or the component site common interest subdivision documents that do not meet California regulatory requirements, the developer should provide either authoritative legal support for those provisions (such as copies of the situs state’s statutes or regulations that require the provisions) or other justification for the contrary provisions. It may be helpful under certain circumstances to request that the SRP submit copies of the situs states’ statutes to confirm whether certain provisions are mandated.

It is important that the Deputy take notice of the provisions under Code Sections 11251 and under certain subdivisions of Article 4, Management and Governance, Code Sections 11265 through 11275, allowing governing and managements documents not to include specific provisions of those Code Sections if the laws of the situs state conflict with those specific provisions. They include Section 11265(Assessment requirements), Section 11267 (Provisions for management agreements), 11272 (Information, including financial statements, to be given to time-share interests owners) and Section 11273 (Records to be made available to time-share interest owners).

### **Documents for Out-of-State Component Sites**

Because out-of-state subdivision requirements do not often include subdivision requirements comparable to the Subdivision Map Act of California, and because the situs state may have limited regulations regarding such subdivisions, the Department may be the only regulatory agency with any subdivision review duties involving some component sites. See *Subdivision Map Act* earlier in this manual for a discussion on out-of-state subdivision maps.

There are out-of-state jurisdictions that do not have title systems similar to that of California. In those cases, preliminary title reports comparable to California's title report may not be available. Another form of title report may be submitted or an attorney's opinion of title may be provided. These "alternative" forms of assurance of title should be examined closely for validity and completeness. If the Deputy is not certain of the validity or the substance of the title document it should be referred to the Legal Section for review.

If the component site is in a foreign country, the title document should be referred to the Legal Section for review. If the language of that country is not English, both the copies of the original documents for the subdivision and English translations of those documents should be provided. These documents might include governing documents and any other documents having to do with the subdivision. The title documents should be referred to the Legal Section for review. If the Deputy is satisfied as to the validity of the English translations, the Deputy may review the documents without the assistance of Legal counsel. If the Deputy has any questions regarding the validity or meaning of the documents, those questions should be referred to the Legal Section.

### **EXCHANGE PROGRAMS – SECTION 11216**

Pursuant to Section 11216 an exchange program is not a part of a time-share plan offering and, except as provided in this section and Section 11238, shall not be subject to either the Vacation Timeshare Ownership Act or the regulations of the commissioner. The Developer is required to make specific disclosures about the exchange program as specified in Section 11216.

The Department developed the following exchange program note, as listed in the Timeshare Plan Disclosures (Part 1) – RE622I, which is to be included in Public Reports on all time-share projects that are affiliated with exchange programs:

“This time-share project may be affiliated with one or more exchange programs whereby time-share owners may voluntarily exchange the right to use and occupy accommodations and facilities in this project with accommodations in other projects. Exchange programs are not subject to Department of Real Estate laws and regulations. Therefore, the Department of Real Estate has not evaluated any exchange program(s) included in this offering. There is no guarantee that this project will remain affiliated with any particular exchange program. Since exchange programs are unregulated, the Department recommends prospective purchasers use discretion in evaluating exchange programs offered in conjunction with time-share offerings.”

## **EXIT, SAMPLER, OR SHORT TERM PRODUCTS**

Time-share developers may choose to offer to prospective purchasers, who do not initially purchase a time-share interest, an opportunity to purchase a short term right to use the time-share project with the understanding that all payments can be credited towards the future purchase of a time-share interval. These types of marketing programs are often referred to as *exit programs*, *sampler programs*, or *short term programs*.

A short-term product is defined in Section 11212(v) as the right to use accommodations on a one-time or recurring basis for a period or periods not to exceed 30 days per stay and for a term of 3 years or less, and that includes an agreement that all or a portion of the proceeds paid by the purchaser for the short-term product will be applied or credited against the price of the future purchase of a time-share interest and that the price will be locked-in at that time.

Code Section 11235 establishes the specific regulatory requirements for short-term products. They include the requirement that there be in the purchase contract for a short-term product, a disclosure that the purchaser has the right to rescind the contract within 7 days following the date the contract was first made, or a later date as provided for in the contract. The developer is also required to disclose to the purchaser, clearly and conspicuously, in writing, specific information about the short-term product described in that code section. The developer may impound purchase money in escrow until the rescission period ends, post a bond to secure the return of purchase monies in an amount determined by the commissioner or make alternative arrangements satisfactory to the commissioner to secure the obligation to return purchase money funds.

## **POINTS-BASED TIME-SHARE PLANS – SECTIONS 11233 AND 11250**

Point systems are structures for flexible use whereby the value of the use right of a time-share interest owner is expressed in terms of points rather than in increments of time.

The product sold to a purchaser may consist of a time-share estate or time-share use not coupled with an estate in real property. The value of the reservation right is entirely a function of the number of points the purchaser receives at the time of purchase. The number of points conveyed to a purchaser is typically shown in the purchase agreement. Sometimes, they may be denoted in the Grant Deed, if the offering is an estate offering. Regardless of the number of points purchased, that number does not change unless the time-share owner purchases more points at a later time.

Point valuations for each unit-type, season or portion of the year, and each resort, if the offering is a multi-site time-share project, should be established in the recorded Declaration for the project. Section 11250 requires the timeshare plan maintain a one-to-one purchaser to accommodation ratio. The Deputy should inquire about how point values are calculated, whether additional points may be purchased in the future and how those additional points may be purchased. The Deputy should be certain that the number of points to be offered for sale is consistent with the total number of points assigned by the developer to the property as shown in the Declaration. The Deputy should also ascertain whether the number of points assigned by the developer to each element of the offering (type of unit, time of year, resort, etc.) works logically in the context of the total offering.

The developer is required by Section 11233 to provide the following information and assurances on timeshare point systems:

(a) Whether additional points may be acquired by purchase or otherwise, in the future and the manner in which future purchases of points may be made.

- (b) The transferability of points to other persons, other years or other time-share plans.
- (c) A copy of the then-current point value use directory, along with rules and procedures for changes by the developer or the association in the manner in which point values may be used.
- (1) No change exceeding 10 percent per annum in the manner in which point values may be used may be made without the assent of at least 25 percent of the voting power of the association other than the developer.
- (2) No time-share interest owner shall be prevented from using a time-share plan as a result of changes in the manner in which point values may be used.
- (3) In the event point values are changed or adjusted, no time-share owner shall be prevented from using his or her home resort in the same manner as was provided for under the original purchase contract.
- (d) Any limitations or restrictions upon the use of point values.
- (e) A description of an inventory control system that will ensure compliance with Section 11250.

The Deputy should require the submittal of a detailed statement from escrow depository also explaining its inventory control procedures.

## **INCIDENTAL BENEFITS**

Incidental Benefits are defined in Section 11212(m) of the Business and Professions Code as an accommodation, product, service, discount, or other benefit, other than an exchange program, which is offered prior to the end of the rescission period set forth in Code Section 11238, the continuing availability of which is limited to a term of not more than 3 years, subject to renewal or extension. The term shall not include the use of the accommodation, product, service, discount, or other benefit on a free or discounted one-time basis.

Under Code Section 11237, if a purchaser of a time-share interest in a time-share plan is offered the opportunity to acquire an incidental benefit in connection with the sale of a time-share interest, the developer shall provide the purchaser with a disclosure statement containing all of the following information:

- (1) A general description of the incidental benefit, including the terms and conditions governing the use of the incidental benefit.
- (2) A statement that the continued availability of the incidental benefit is not necessary for the use and enjoyment of the purchaser's use of any accommodation of the time-share plan.
- (3) A statement that the purchaser's use of or participation in the incidental benefit is completely voluntary, and payment of any fee or other cost associated with the incidental benefit is required only upon that use or participation.
- (4) A listing of the fees, if any, that the purchaser will be required to pay to use the incidental benefit.
- (5) A statement that no costs of acquisition, operation, maintenance, or repair of the incidental benefit shall be passed on to purchasers of time-share interests in the time-share plan as a common expense of the time-share plan.

A developer shall include in its initial application for registration, a description of any incidental benefits which may be used by the developer. The developer may, but shall not be required to describe the incidental benefits in the public report for the time-share plan.

The incidental benefit disclosure is not required to be filed with the commissioner prior to the use of the disclosure. However, the commissioner may request and review the records of the developer to ensure that the incidental benefit disclosure required by this section has been given to purchasers and to ensure that the statements required to be made in the disclosure are accurate as to the operation of each incidental benefit offered by the developer. The developer shall deliver the records to the commissioner within 10 business days of the commissioner's request.

The developer is also asked, through the application (RE 668A and RE 668B), to describe each Incidental Benefit to be offered. The Public Report will include a generic disclosure regarding the fact that the developer may offer incidental benefits. Disclosures regarding Incidental Benefits should be included as explained in RE 622I.

### **PUBLIC REPORT – SECTION 11234**

The developer is REQUIRED by section 11234 to submit a pre-typed public report as part of the Notice of Intention. The public report may, but need not, have exhibits other than the budget. If governing documents, including the management agreement, are not attached as exhibits, they must be handed out separately to each purchaser. Detailed instructions for preparation of the public report can be found in Time-Share Public Report Preparation – RE622H. Forms RE622I, RE622J-1, RE622J-2 and RE622J-3 provide time-share disclosures for use in developing the public report language.