



STATE BOARD OF EQUALIZATION

1020 N STREET, SACRAMENTO, CALIFORNIA
P.O. BOX 1799, SACRAMENTO, CALIFORNIA 95808
(916-445-4982)

GEORGE R. REILLY
First District, San Francisco
ERNEST J. DRONENBURG, JR.
Second District, San Diego
WILLIAM M. BENNETT
Third District, San Rafael
RICHARD NEVINS
Fourth District, Pasadena
KENNETH CORY
Controller, Sacramento
DOUGLAS D. BELL
Executive Secretary
No. 82/92

July 27, 1982

TO COUNTY ASSESSORS:

THE APPRAISAL AND ASSESSMENT OF TIMESHARES

I. What is a timeshare?

We have received a number of questions concerning the appraisal and assessment of timeshares. Generally, a timeshare entitles the purchaser to use a specified or unspecified unit of real property for a specified period of time. There are two categories of timeshares: timeshare estates and timeshare uses. Timeshares are defined in Section 11003.5 of the Business and Professions Code as follows:

"(a) A 'time-share project' is one in which a purchaser receives the right in perpetuity, for life, or for a term of years, to the recurrent, exclusive use or occupancy of a lot, parcel, unit, or segment of real property, annually or on some other periodic basis, for a period of time that has been or will be allotted from the use or occupancy periods into which the project has been divided.

"(b) A 'time-share estate' is a right of occupancy in a time-share project which is coupled with an estate in the real property.

"(c) A 'time-share use' is a license or contractual or membership right of occupancy in a time-share project which is not coupled with an estate in the real property."

In this letter we will refer to timeshares in which the fee interest is transferred as "timeshare estates" and to all others as "timeshare uses."

As stated, a timeshare estate consists of the right to use a timeshare unit and an undivided fractional ownership of the underlying fee interest in the real property. Generally, the developer of a timeshare estate project transfers his fee simple interest in the real estate to the purchasers of individual timeshares, thereby divesting himself of any further interest in the property. The timeshare purchaser then has an undivided fee interest in the timeshared property. The duration of the fee timeshare may be into perpetuity, as in a fee simple

July 27, 1982

co-ownership of a timeshare unit, or it may be for a limited term, as in a life estate or an estate for years in a timeshare unit. The timeshare estate purchaser receives all the rights inherent in undivided co-ownership of real estate, such as the right to sell, lease or bequeath his interest. Fee timeshares may be termed "undivided interest timeshares" or "interval ownership timeshares" (i.e., a tenancy for years plus a vested remainder as tenant in common with other owners of a timeshare unit).

The purchaser of a timeshare categorized as a timeshare use receives only those rights specifically granted to him by the developer of the timeshare project, which usually means the right to occupy a unit and the related timeshare premises. The duration of this right may range from 15 years or fewer to as long as 99 years. Timeshare use projects can be called "nonfee" timeshare projects because the timeshare developer or his successor in interest remains the fee owner of the real estate.

Timeshare uses are referred to variously as "leasehold interest timeshares," "vacation licenses," "club memberships," and "rights to use." Under certain conditions, any of these formats may be equivalent to a lease. In the recent California appellate court case of Cal-Am Corporation v. Department of Real Estate (104 Cal App.3d 453), decided in April 1980, the court held that a timeshare use interest can be in the nature of a lease. The court found that, regardless of whether it is termed a license, membership or right to use, if the contract gives exclusive possession of the premises against all the world, including the owner, then it is considered a lease. Further, the purchaser's right of exclusive occupancy is an estate or interest or possessory interest in the property itself. Based on the Cal-Am holding, it is our opinion that the creation of a timeshare use, whether called license, lease, membership, or right to use, should be considered an interest in real property, provided that the timeshare use confers upon the purchaser exclusive occupancy, even if only for a portion of each year and for an unspecified time period and unspecified unit.

II. The Appraisal of Timeshares

The appraisal of timeshares for property tax purposes is a topic best approached by considering the development of a timeshare project as it passes from its early stages as construction in progress through its completion and eventual marketing as individual timeshares. This portion of our letter will present our views on the correct methodology of appraising timeshares as related to this "stage of production" concept.

While a timeshare project is being constructed, there should be little difference in the values assigned to either timeshare uses or timeshare estates, because at this point the only elements being valued are the physical components of the timeshare project, i.e., the land and improvements. For this reason, conventional replacement cost estimates, adjusted for the estimated percentage of project completion, may

be appropriate indicators of value. Note that these cost factors are based upon single ownership of building types and would not apply to the valuation of individual timeshares that have been placed in the hands of the final consumer, that is, the purchaser of an individual timeshare interest.

The actual historical costs of development incurred by the timeshare project developer, added to the factored base year value of the land, can also provide an indicator of total timeshare project value. The actual costs incurred while the project is being constructed will not include the sizeable promotional and marketing costs ("soft" costs) that attend the final stages of development of the timeshare project. The historical costs up to this point will not include amounts attributable to placing the single timeshare in the hands of the ultimate consumer, that is, the timeshare purchaser.

The "stage of production" concept applies to timeshare construction in progress. The added utility of timesharing ownership has not yet been added to the dwelling units. The ownership of the total property by a single entity at this point in time requires that the property be appraised like comparable properties not subject to timeshare ownership. It would be incorrect to merely sum the prospective selling prices of the total number of timeshares into which the project has been divided. This would overstate the project value because it would be based upon an inaccurate estimate of the appraisal unit.

When the timeshare project reaches the stage where all physical construction has been completed but no timeshares have been sold, the proper unit of appraisal is still the entire project. At this point, the project should still be valued as a single property, regardless of whether it is a timeshare estate or a timeshare use project. Accordingly, the developer's total historical cost would be one indicator of value, as would a standard replacement cost estimate added to the factored base year value of the land. For both newly constructed projects and for existing developments converted to timeshare projects still under single ownership, the market data approach may be used, relating sales of comparable properties not subject to timeshare ownership.

As individual timeshares are sold to the ultimate consumers, the unit of appraisal changes and becomes the individual timeshare. Generally, the change in ownership of a timeshare estate requires the reappraisal of the interest transferred. Also, the transfer of a timeshare use having an original term of 35 years or more usually requires the reappraisal of the interest transferred.

For both timeshare estates and timeshare uses, the preferred approach to value is the market approach. Of course, because the transfer of the timeshare being reappraised may have been an open market sale, the actual selling price may be the best indicator of value. Nominal (i.e. "gross") selling prices of timeshares are subject to cash equivalency adjustments, just as are the selling prices of other real property;

that is, they should be scrutinized for favorable financing or non-assessable items that may be included in the purchase price.

The income approach to value is somewhat more difficult to apply to an individual timeshare than is the market approach. Timeshares are generally purchased not as investments, but rather as prepaid vacations. As a result, timeshare purchasers do not anticipate a flow of cash income over time, except in rare instances. The amenity they anticipate is a prepaid vacation, guaranteed and free from inconvenience.

In certain situations, an Overall Rate (OAR = Net Income divided by Sales Price) can be employed to arrive at an indicator of the value of an individual timeshare. Certain timeshare resorts offer rental pool arrangements whereby a purchaser can elect to have his timeshared unit rented out by the timeshare management organization, instead of occupying it himself. When the timeshare is in a hotel unit, for instance, room rents and vacancy rates can readily be ascertained. Annual timeshare maintenance fees are fixed amounts and can be treated as operating expenses. These expenses should be deducted from the estimated gross effective income and the resulting net income should be capitalized at an appropriate Overall Rate. As is always the case when employing the Overall Rate, the sold properties from which a rate is selected must be truly comparable to the subject timeshare property.

The Gross Rent Multiplier (GRM), although actually a market indicator, can be applied as an income factor in valuing timeshares. The operation of dividing the adjusted selling prices of comparable timeshares by the total potential rent generated by comparable vacation units can yield a useful multiplier. Because peak and swing season rental rates can vary dramatically, however, rental rates must be selected that are appropriate to the season in which the timeshare is held.

The conventional replacement cost approach is deficient as an indicator of the value of an individual timeshare because most square foot costs are predicated on single ownership of improvements. The added ownership utility of timesharing is not reflected in the cost factors.

In addition, timeshare projects usually involve a relatively large selling and promotional expense. Factors contributing to this disproportionately large marketing expense include the distances at which most timeshare resorts are located from the urban centers where the timeshares are marketed, as well as the high costs of entertaining potential timeshare purchasers with free or discounted weekends at timeshare resorts. This "soft" portion of the timeshare project cost is not included in conventional tables of cost factors. Such costs should be considered as elements to be included in the market value of a timeshare.

The purchase price of an individual timeshare, carefully adjusted for the influence of financing and the inclusion of nonassessable items in the timeshare package, can be a reliable indicator of the timeshare's

value. Most timeshares include personal property such as furniture, bedding and linen and completely outfitted kitchens. The full value of any such personalty, which is exempt from taxation provided that it qualifies as "household furnishings" within the meaning of Revenue and Taxation Code Section 224, should be allocated among the timeshares comprising each vacation unit. The allocated value of the personalty should then be deducted from the nominal selling price of the timeshare.

Other nonassessable items that are frequently included in the timeshare purchase price are memberships in timeshare exchange networks and club memberships. Currently there are two major exchange networks: Interval International and Resort Condominiums International. Timeshare project developers must pay a fee to enroll their projects in these networks. Additional fees are charged to each timeshare purchaser for the initial membership, and there are ongoing annual dues as well. Often the initial membership fee is included in the purchase price of the timeshare. Appraisal judgment is called for in estimating the value of this membership right and deducting it from the purchase price. Our information from Interval International in Florida is that their annual membership fee for individuals is \$45 (\$60 if the individual owns timeshare interests in more than one Interval International resort affiliate). An exchange fee of \$49 is charged for each successful exchange. Currently, the initial fee charged to enroll an entire U.S. timeshare project in I.I.'s exchange program is \$6,900. The resort must affiliate with Interval International in order to offer Interval International's program to individual members. Renewal of individual memberships is strictly optional after the first year.

Certain timeshare resorts will include membership in recreational enterprises which are under separate ownership as part of the timeshare package. The purchaser of a timeshare interest in such a resort becomes a member of a tennis club, for example, by virtue of his timeshare purchase. If such memberships, which allow the use of common recreational facilities, can readily be obtained by individuals without their also purchasing a timeshare interest, the value of the membership can be identified and should be deducted from the purchase price of the timeshare. If club memberships are available exclusively to timeshare purchasers--in other words, if every timeshare owner is also a club member, and only timeshare owners can be club members--then it may be difficult to assign any separate value to this intangible right of membership. The offer of club membership as an added bonus for purchasing a timeshare would seem to be a marketing technique in this case.

A final nonassessable item that may be included in the purchase price of a timeshare is the prepaid expense. If the first year's maintenance fee, for instance, is collected at the time the timeshare purchase is consummated, it should not be considered part of the purchase price. Some timeshare resorts will collect from all timeshare purchasers a one-time assessment which is paid to the timeshare project organization to defray organization costs. This should not be included in the value of the timeshare.

When reappraising individual timeshares because of a change in ownership, several statutory provisions must be recognized. The primary one is that Revenue and Taxation Code Section 61(c) includes in the definition of change in ownership the creation of a leasehold interest in taxable real property for a term of 35 years or more, including renewal options. This section further provides that only the portion of the property subject to such a lease shall be considered to have undergone a change in ownership. This means that the sale or transfer of a timeshare use which conveys use for 35 years or longer, whether it is termed a license, membership, lease or right to use, is a statutory change in ownership requiring reappraisal of that timeshare interest.

Still another change in ownership statute affecting the appraisal of timeshares is Revenue and Taxation Code Section 65.1, which provides that the transfer of an interest in a portion of real property requires that only the interest transferred be reappraised. There shall be no reappraisal if the interest transferred represents less than 5 percent of the market value of the entire property and has a value of less than \$10,000; however, these transfers are to be accumulated during each assessment year. When the minimum value/percentage threshold has been crossed, the cumulative interests transferred must be reappraised. Although it is unlikely that any single timeshare would represent 5 percent or more of a timeshare project's value, it is not uncommon for individual timeshares to sell for more than \$10,000.

Senate Bill 1260, Chapter 1081 of the Statutes of 1980, added Section 65.1 to the Revenue and Taxation Code. This section modified the previously existing requirement that a transfer of an undivided interest of less than 5 percent shall not be reappraised. As a result of SB 1260, this requirement was revised to provide that a change in ownership of an interest in a portion of real property with a market value of less than 5 percent of the value of the total property shall not be reappraised if the market value of the interest transferred is less than \$10,000. Because SB 1260 is silent on the issue of its effective date, we conclude that the \$10,000 minimum value requirement is not retrospective and should not be applied to transfers of timeshare interests occurring before March 1, 1979.

A final statute affecting the appraisal of timeshares is Section 2812.2 of Chapter 6 of Title 10 of the California Administrative Code. This Section allows the Department of Real Estate to require the transfer of a timeshare use or timeshare estate project subject to a blanket encumbrance into an irrevocable trust for the duration of the timeshare. The purpose of this requirement is to protect purchasers, especially purchasers of timeshare uses, against the further encumbrance or sale of the property by the developer.

Although it protects timeshare purchasers, this Section could also trigger the reappraisal of the timeshare property. The transfer of real property into an irrevocable trust in which the trustor is not the sole present beneficiary constitutes a change in ownership; therefore,

July 27, 1982

it is possible that reappraisal of the entire project could be required upon creation of the trust. If this were so, and the timeshare property were to revert to the trustor upon termination of the trust, yet another reappraisal could be required. These trusts should be reviewed

individually on a case-by-case basis, to determine whether a change in ownership has taken place.

III. Assessment of Timeshares

Although current law allows the separate assessment of condominiums, planned developments, community apartment projects, housing cooperatives, certain leased land, and undivided interests not to exceed four per parcel, there are to date no provisions for the separate assessment of timeshare interests. This means that, lacking statutory directive, the assessor is not required to make more than a single assessment of any timeshare project. He should reappraise all timeshare estates and qualifying timeshare uses upon change in ownership, of course, and should maintain separate base years and base year values on the individual timeshares in a timeshare project; but there is no requirement that there be more than a single entry of the total timeshare project's value on the local tax roll. The tax collector will bill the owner of the timeshare project for the total amount of taxes due. In other words, tax billing for timeshare projects must be singular and cumulative until there is a change in the property tax statutes.

Senate Bill 1276, introduced by Senators Beverly and Presley, offers a solution to this assessment problem. As amended May 17, 1982, this measure would make timeshare estates or timeshare uses eligible for separate assessment, upon written request of the timeshare association, and would also authorize the assessor to charge a fee for the initial cost of separately assessing these interests. This bill would also provide for the separate tax billing of certain timeshare estates when a fee simple interest has been conveyed to the individual interest owner. Timeshare use projects and timeshare estate properties in which individual interest owners do not have a fee simple interest would receive a single tax bill with an itemization of taxes for each separately assessed interest. The tax on a timeshare estate when fee simple interests have been conveyed to the individual interest owners would constitute a lien solely on such interest and would be subject to all provisions of law applicable to taxes on the secured roll. The tax on the cumulated separate assessments in a timeshare use project and in a timeshare estate project not qualifying for separate tax bills would be a lien on the entire timeshare project and would also be subject to all secured roll procedures.

TO COUNTY ASSESSORS

-8-

July 27, 1982

We anticipate that you will have further questions on the subject of the assessment of timeshares. Please address them to our Technical Services Section, whose telephone number is (916) 445-4982.

Sincerely,



Verne Walton, Chief
Assessment Standards Division

VW:scm
AL-13-1352A



STATE BOARD OF EQUALIZATION

1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 1799, SACRAMENTO, CALIFORNIA 95808)
(916) 445-4982

GEORGE R. REILLY
First District, San Francisco
ERNEST J. DRONENBURG, JR.
Second District, San Diego
WILLIAM M. BENNETT
Third District, San Rafael
RICHARD NEVINS
Fourth District, Pasadena
KENNETH CORY
Controller, Sacramento
DOUGLAS D. BEL
Executive Secretary
No. 82/122

October 20, 1982

TO COUNTY ASSESSORS:

SEPARATE ASSESSMENT OF TIMESHARES

Senate Bill 1276 was approved by the Governor, September 9, 1982 and is Chapter 887 of the statutes of 1982. This legislation added Sections 2188.8 and 2188.9 to the Revenue and Taxation Code. These sections provide for separate assessment of timeshare properties.

Section 2188.8 requires the assessor to separately assess the timeshare estates in a timeshare project upon receipt of: (1) a written request that has been certified as approved in a manner provided in the organizational documents of the timeshare project, (2) a copy of the documents setting forth the procedures for scheduling time and units to each owner, (3) a diagrammatic floor plan, and (4) a list of every timeshare estate owner including date of acquisition. Additionally, the assessor may request a plot map of the land showing improvement location. The organization must file an annual statement, on or before April 1, listing any changes in the required information. Further, for purposes of this section, the term "timeshare estate" refers to those timeshares that include a fee simple interest (e.g. and undivided interest) in the underlying property involved. Excluded from this term are timeshare estates that are coupled with a leasehold interest or an estate for years. These timeshare estates will receive separate tax bills, and the taxes levied will be a lien solely on each individually owned timeshare estate rather than the entire project. These separate assessments shall be entered on the secured roll.

Section 2188.9 requires the assessor to separately assess the interests in a timeshare project upon receipt of the information listed above. Although this section requires separate assessment of these interests, it differs from Section 2188.8 in that it requires that the separate assessments be cumulated and that a single tax bill be sent in the name of the organization or timeshare owners' association. The tax shall be a lien on the total project rather than the separate interests. The section further requires the assessor to notify assesseees of any increased assessment of individual timeshare interests, and that the tax collector detail the taxes applicable to each separate assessment.

TO COUNTY ASSESSORS

-2-

Both of these sections provide that separate assessment shall occur on the first lien date occurring more than 60 days following the request; and, once separate assessment is begun, it is binding on all future owners. Both sections also provide that a fee may be charged (not to exceed actual cost) for the initial cost of separate assessments. In the case of timeshare estates, ongoing costs may be recovered also, and fees charged shall be proportioned to timeshare estate owners and collected commencing with the initial separate tax bills.

For timeshare assessments, the interest to be separately assessed is the value of the right of recurrent, exclusive use or occupancy of real property, annually or on some other periodic basis, for the use or occupancy periods into which the project has been divided.

This legislation was passed as an urgency statute and takes effect immediately. The first separate assessments possible will be for March 1, 1983.

A copy of the legislation is enclosed. If you have any questions please contact our Technical Services Section at (916) 445-4982.

Sincerely,



Verne Walton, Chief
Assessment Standards Division

VW:ab
AL-04-0610A
Enclosure