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.