Fractional Ownership of Real Estate in the Dubai Hospitality Sector

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The concept has been adapted to a number of different types of assets, such as executive jet aircraft, luxury yachts, classic cars, racehorses, and works of art. However, the fractional ownership of real estate as a product did not come to prominence until the 1990s in luxury ski resorts in the USA, where the cost of property was high and in short supply. Since then, the model has spread to other areas of the world, such as the Caribbean and Southern Europe, as a more economical alternative to outright second home ownership.

Although containing many similarities, it differs from typical ‘timeshare’ schemes (which in some countries has had somewhat of a tarnished reputation), in that it involves part ownership of a property, rather than just a right to use it at certain times of the year. Annual usage allowances with fractionally owned property also tend to be longer than with timeshare, and the size and quality of fractional ownership properties may generally be better, with superior access to facilities and services, than those of timeshare properties.

Fractional ownership of real estate typically involves multiple co-owners (usually four to six), either each acquiring an undivided share in the property itself or separate shares in a special purpose vehicle (‘SPV’) that owns the title to the whole of the relevant property. Fractional shares are usually bought by investors in cash, due to the inherent difficulties in securing a mortgage or other types of financing for such arrangements, although some developers in some jurisdictions do offer financing options.

The allocation of usage time for each co-owner typically works by each co-owner having an exclusive right to use the property for a specified number of days, weeks, or months each year. Such periods can be fixed (usually adopted in locations where there is less evident seasonality), floating (often seen where seasonality is more of an issue and where a co-owner’s use allocation rotates around the calendar year between peak and off-season), or a mixture of both.

This model has been adopted by the hospitality industry in various forms, including the concept of private residence clubs, which usually involves the fractional ownership of a hotel apartment or villa located at a premier resort destination that is managed by a high end hotel operator. These are aimed at affluent investors that, although could perhaps afford to buy a second home outright, prefer not to invest in a whole property given its likely infrequent use.

There is a very wide array of structures adopted for such schemes. However, a typical arrangement might involve:

- the investors each entering into a sale and purchase agreement with the developer relating to the acquisition of a proprietary share in the property itself or shares in an SPV established to own the property;
- the rights and obligations of the various co-owners being set out in a co-owners agreement or, where applicable, the property owning SPV’s constitutional documents.
- a leaseback of the property to the developer, in order for it to be placed into the hotel rental pool to be managed by the hotel operator in accordance with its brand standards, subject to the co-owners’ usage

rights. Rental income can then be used to off-set against the shared costs of the operating expenses and other costs such as furniture, fixtures, and equipment (‘FF&E’) reserve contributions, marketing fees, and the operator’s fees. Such leaseback agreement will usually also contain the relevant fractional owner’s acknowledgment of the branded operator’s management of the property and may, if there is a strata model of ownership adopted for the hotel development, provide the developer with certain voting rights on behalf of the fractional co-owners, which allows the developer to maintain control of management decisions (and which may also be maintained through the retention of shares and the form of the company’s constitutional documents if the purchasers are investing in an SPV).

There are many potential benefits for investors, developers, and hotel operators with such schemes.

For the investor, through owning a part share of a property, such schemes offer a relatively hassle-free option of a luxury second home with the back-up, security, and facilities of a five star resort. It also provides a proportional saving on property expenses and saves time on dealing with maintenance issues and managing the accommodation of guests. Placing the property into the hotel rental pool may also generate an annual net profit. There is also the possibility of capital appreciation upon resale of the fractional share (although investors are usually locked in for a certain time period).

For the developer, if such fractional interests are being sold off-plan, this gives it access to a different group of investors and source of financing, which may be particularly useful in a depressed market when sales of whole units are slow. It may also assist with obtaining other development finance. Fractional ownership is also likely to generally increase the usage of the hotel and increase sales of goods and a la carte services.

For the operator, it increases the overall revenue stream, and thus, ultimately, the level of its remuneration relating to the particular hotel development.

Dubai, given its increasing growth as a global tourist and key business destination, is well aligned to take advantage of the benefits of fractional ownership. However, in terms of current real estate law and practice in Dubai, there are a number of difficulties in seeking to introduce such schemes. Although there are some limited provisions in the UAE Civil Code relating to co-ownership and time usage, there are no specific laws relating to the fractional ownership of property or similar structures.

There are also a number of inherent difficulties in implementing such schemes at the present time. Firstly, any such schemes are likely to be targeted at both GCC and international investors resulting in, at least an element of, foreign ownership of the relevant asset or property owning SPV. Therefore, foreign ownership restrictions need to be considered, with such schemes likely to be limited to those areas designated for foreign freehold investment. In addition, in relation to a shared title, it is likely to be problematic registering multiple co-owners with specified percentages of ownership on the relevant title deed. Investment in shares in a property owning SPV is also likely to pose difficulties – primarily because each and every change in shareholding of a company owning property in one of the designated foreign freehold areas would, under current practice, trigger a transfer fee liability. This transfer fee liability would be four per cent of the value of the property prorated in accordance with the relevant change in shareholding. This means that fractional owners may be restricted from selling their respective individual shares until the property, as a whole, is sold. Such illiquidity is likely to be a turn-off for investors.

There has been an understandable wariness by the Dubai authorities to date of putting a legal framework in place that would promote the implementation of such fractional ownership schemes. Indeed, a designated property timeshare law, which may reference fractional ownership models, has long been mooted but has not, as yet, materialised. It is essential, in terms of consumer protection, that such schemes are properly regulated through carefully considered legislation.