GAINER LAW

Home Ownership Sharing by Unmarried Folks

Is it love money or both?

by Stephen R. Gainer

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Introduction

> ***"On first appearance, getting into a shared ownership of a home seems incredibly easy and the least expensive side of the investment.... But such 'ease' is an illusion. Even this initial purchase aspect calls for some thoughtful advice ...."***

The purchase of a home together by people who are not married, or haven't registered for an 'almost marriage' status such as the "registered domestic partner" relationship permitted in California, is a common approach for getting into real estate ownership in a very expensive market. This **co-ownership** or **equity sharing** relationship can be part of a romantic relationship or just a business relationship.

On first appearance, getting into this kind of relationship seems incredibly easy and the least expensive side of the investment. The investors need to merely place their joint funds and any funds from a home purchase loan into escrow, joined in escrow by the home seller and the seller's lender (who wants to get its loan paid off in escrow) and the investors' lender, and when the escrow "closes" the investors find themselves both listed as the new owners of the home.

But such "ease" is an illusion. Even this initial purchase aspect calls for some thoughtful advice regarding the form in which the investors are to own the home. Under one form of ownership called **tenancy in common** the investors own the home in the share they agreed upon (half and half, 60% - 40%, etc.) and if one investor dies while they both own the home, the surviving "heirs" of the deceased investor (whomever is entitled to his or her property by will, trust, or the law) now get his or her share. Under another form of ownership called **joint tenancy**, each investor must start with ownership of an equal share of the home, and if one investor dies the surviving investor or investors get the deceased investor's full share regardless of any contrary gift the deceased investor made in his or her will, etc. The "joint tenancy" form of ownership is popular for ownership of a home among (hopefully loving) family members since this form permits an easy at-death transfer of the home to the surviving family member or members.
However, it is hard to imagine this form appealing to co-investors in a home whose relationships together are purely economically motivated. There is now even a hybrid form of ownership by married couples combining elements of joint tenancy ownership with the "community property" laws governing property ownership among married couples in California.

If the investors are not going to own the property in the joint tenancy form (where the dead owner's interest passes automatically to the still-living owner), they need to decide if theywant to own the property directly as "tenants in common" or indirectly as owners of a businessentity which will directly own the property – for example, as partners in a partnership, shareholders in a corporation or members of a limited liability company formed for property holding purposes. When a business entity will directly own the property, then the investors share their investment together in the proportions in which they own that business (for example, as the owner of 51% of the shares of a corporation versus the owner of 49% of the shares).

The investors may want to arrange for passage of ownership at death in some way other than by the rigid formula of tenancy in common or percentage of ownership of a business entity that directly owns the property. For example, the investors may want one investor to get all or most of the profits from a rental of the house to non-investor tenants, while the other investor gets all or most of the profits from a sale of the house.

And, even investors coming together for business purposes may not be happy to leave after-death passage of interests in the jointly owned property pass according to the rules for the tenancy in common form or entity percentage form because of the possibility that the dead owner's interest will pass to a survivor (a spouse or siblings or children) whom the surviving coowner does not want to be involved with in a business relationship. Thus in most investment-purposed co-ownership relations the co-owners will want to have what I broadly call a **co-owner buy-out agreement** (in the form of a "cotenancy buy-out agreement", "partner buy-out agreement", "shareholder buy-out agreement", or limited liability company "member buy-out agreement", depending on how ownership in the property is held). Any co-owner buy-out agreement should deal with these questions:

> ***"All co-owner relationship issues are best addressed by people before they become co-owners, at a point in time which is 'context-neutral' -- that is, a point in time when the owners can think, beyond mere self-interest or immediate need, about what each can agree would be a 'fair' result upon the happening of certain events."***

1 If one co-owner (for ease of reading, the "selling co-owner") dies or becomes" disabled" or wants to retire and so the sale of his or her interest is begun at the selling co-owner's initiative or the initiative of his/her representative,

a must that co-owner (or in the case of death, that co-owner's representatives) first offer his or her investment interest in the property (or his interest in the entity directly owning the property) to the remaining co-owners

— before selling that interest to outsiders?

— before that interest passes to the survivors of the dead co-owner?

b how is the sale price of the co-owner's interest determined?

— by appraisal by an expert business appraiser?

— by first getting a sale price figure based on tentative bids by outsiders?

c. How long do the remaining co-owners have to decide whether or not to make the buy-out?

d. Must the remaining co-owners buy the entire interest of the selling co-owner, or can they just buy a portion of it leaving the selling co-owner free to try to sell the rest of his or her interest to outsiders?

e. If there is more than one remaining co-owner who wants to buy the selling co-owner's interest, how do we "divvy-up" or allocate the purchase rights among these interested remaining co-owners?

f. Must the remaining co-owners purchase the selling co-owner's interest all at once and make one payment, or can they make the purchase over time? If they can make the purchase over time, must they treat this over-time purchase as a form of loan so that they must pay interest on the unpaid purchase price balance?

g. Should all the owners anticipate a buy-out situation arising and therefor all pay premiums on insurance on the life of each co-owner and in anticipation of a "disability" of each co-owner, with the insurance proceeds to be used to fund a buyout when a selling co-owner dies or becomes disabled?

h. What criteria determines if a co-owner is "disabled" so that he or she can demand a buyout of his/her investment interest?

— examination and opinion of a particular physician or physicians?

— determination by the insurance company that provides the death

2 What happens if a co-owner does not himself or through his authorized representative initiate a sale of his interest upon an event such as his death or disability but instead the other co-owners want to buy him or her (or their heirs) out on the occurrence of the event? Are the arrangements listed above in the case where a selling co-owner initiates the buy-out process to be also followed, with any appropriate adjustments?

To address these concerns the investors will want to prepare a written co-ownership agreement.

There are many other issues the investors ought to address. A few of these are:

1 Are all co-owners planning at least initially to live in the home they are buying together?

a If so, how will they allocate responsibilities for payment of expenses directly related to the property, such as mortgage payments, utilities, property taxes, condominium association dues, special billings or assessments by the condominium association, repair costs?

(i) In proportion to their relative contributions to the down payment for the home purchase?

(ii) On some other basis because of unequal needs of on co-owner for certain utilities, etc.?

b Should they set up a joint checking account and deposit a lump sum or monthly amounts so as to meet anticipated expenditures?

2 If none of the co-owners are planning to initially live in the home they are buying together and instead plan to rent it out to one or more outsiders.

a How is rent to be treated?

(i) Placed in a checking account?

(ii) How much of this rent should be kept in the checking account as a reserve for anticipated expenses?

b What are the consequences if one co-owner can't meet his/her share of expenses such as mortgage payments, utilities, property taxes, repair costs. If the other co-owners "cover" for the nonpaying co-owner's share, what will be the arrangement for reimbursing these covering co-owners?

(i) Is the amount covered treated as a loan to the nonpaying co-owner?

- If so, is interest added on?
- Must this loan plus accrued interest be paid off at a fixed date in the future?
  - What if the nonpaying owner fails to pay off thel loan on that date?
- Can payoff of this loan wait until the property is sold, and then be paid off if there are profits on the sale after paying off sale expenses, and paid off before the co-owners divide up any sale profits?
- Should the loan and any agreed upon accruing interest be treated as additional investment contributions to the property by the covering co-owners, so that their percentage ownership interest in the property increases relative to the ownership interest of the nonpaying coowner? If the percentage ownership is thus increased,
  - will this increase the proportional share of income to the covering owners from rents paid by nonowner tenants even if such arrangement gives them an added share of such income profits much exceeding the amount of the expenses they covered for the nonpaying co-owner? Or, should this added allocation of rent prof-

its be stopped once the amount of the covered nonpayment has been reached?

- will this increase the proportional share of profits to the covering owners from sale of the property even if such arrangement gives them an added share of profits much exceeding the amount of the expenses they covered for the nonpaying co-owner.

- does this proportionately increase the "voice" or voting power to make decisions for the investment on the part of the covering co-owners relative to the voice of the nonpaying co-owner?

3 If all of the co-owners are planning to initially live in the home they are buying together, what will be the arrangements if one co-owner moves out and i replaced by a non-owner renter?

a As to the co-owners who remain at the home, do they now pay rent into the bank account set up for the property?

(i) How is this amount of rent determined?

b Do the arrangements described above when there are no co-owner occupiers from the beginning of the investment now apply?

All of these issues are best addressed by people before they become co-owners, at a point in time which I often characterize as "context-neutral" -- that is, a point in time when the owners can think, beyond mere self-interest or immediate need, about what each can agree would be a"fair" result upon the happening of certain events. Also, addressing these issues early can help sort out the "romantic" compatibility of a new couple or their attraction as friends from their compatibility on "financial" issues. I am reminded of two of my clients:

- A gay male client (a very decisive and financially wise loan broker) who enjoyed seeing his gay landlord partner (a leisure-paced psychologist) at social functions but was exasperated by the slowness of his partner in reaching any decisions on their condo or in acting upon these decisions.

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- My woman client who was very careful in her money-spending habits and who bought a house with a male lover and potential husband whom she found absolutely charming but who was literally going bankrupt buying large interest in retired thoroughbred racing horses, and hence was having difficulty paying his share of home ownership expenses.

There are "do-it-yourself" forms which will lay out a lot of the "checklist items" listed above, but sophisticated investors recognize that these items have many subtle options and choosing among the best options calls for use of an attorney who discusses the background and goals for the investment and any particular concerns or needs or other issues (health, marital status, etc.) of each potential investor.

"Particularly for romantic couples who buy a home together and then move into the home, it is very important to have a written agreement when there is substantial 'financial imbalance' between them."

And, particularly for romantic couples who buy a home together and then move into the home, it is very important to have a written agreement when there is substantial "financial imbalance" between them. I am always reminded of the shock to many of my clients who bought a house with a lover mostly with that client's assets for the down payment and even for ongoing loan payments, and then spent years together, and then discovered that a court might well believe that my client had demonstrated an intent to share equally in the profits from later rentingout to a stranger or any sale of the house or an intent to financially support the lower income lover. The lower-income lover can prevail if a California court finds that there was an agreement for the lower-income lover to provide "services" to the challenging lover along a whole range of "companionship" and "emotional support" and "social hosting" or "business guest hosting" functions so long as the court does not believe that the primary "services" to the challenging lover were sexual. In particular, I recall a male client whose former live-in lover claimed she had kept an undemanding low paying job because my client asked her to dedicate her time and energy to entertaining his business clients and giving him emotional support in his start-up business and acting as his part-time housekeeper and bookkeeper and she was now demanding a half share in ownership of my client's home even though her financial contributions amounted to occasional mortgage payments and payments for minor remodeling projects.

Without a tailored written agreement between or among them, people often enter into home ownership together for love, money, or both but depart without love and without money from their home investment together.