

“DOCKOMINIUM” DEVELOPMENT AND STRUCTURING

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- I. Movement of Americans to the Coasts:
 - A. The concept of “fly over” country
 - 1. There is a tremendous shortage on the coasts today of either “dry” or “wet” slips for people to dock their boats. Additionally, many people who ply the waters of navigable waters, such as the Atlantic Intracoastal Waterway, have great difficulty securing temporary moorings for their vessels.
 - 2. Dockominium activity has exploded in recent years. Many marina owners along the South Carolina coast have taken advantage of the lucrative investment return by selling wet slip or dry dock also known as dry stack condominiums or “dockominiums”.
- II. Wet Slip and Dry Dock Condominiums (“Dockominiums”)
 - A. The name “dockominium” has been bandied around by many but the legal structure may differ. Normally, as the name suggests, it is the adaptation of the concept of the land-based condominiums to the water.
 - 1. But it can also be a limited common element within a traditional condominium project or a “license” to use a boat slip.
 - B. Definition: A proprietary interest in fee to a particular boat slip. Ownership of the slip – which is the maritime equivalent of an automobile parking space -- usually gives the owner not only an exclusive right to occupy the slip but also the right to use the common elements of the marina such as parking, showers and picnic shelters similar to a condominium unit owner’s right to use common areas of a condominium complex.
 - C. The concept first came into vogue in the 1980’s when production of pleasure boats exploded.
- III. Creation and Use: Why it’s Hot
 - A. Marina owners have either been converting existing marinas slips to condominiums or building new marinas and pre-selling slips with reference to a proposed Master Deed which has yet to be recorded.
 - B. The difference in the amount that owner could sell and entire marina (slips, dock facilities, appurtenant highland, building and improvements, lifts and other equipment used for transporting boats—usually in the dry stack context) that has not been condo’ed compared to selling the slips individually by creating a condo regime is generally significant. This

return, combined with the fact that consumers see the continued coastal development and limited available space for dock slips, has spurred growth in dockminiums along the United States coasts.

IV. The renewed interest in the dockminium concept comes from a variety of individuals, existing owners of marinas, potential buyers of marinas, and marina developers.

A. No definitive reason as to why the renewed interest in a concept that for the most part failed in the late 1980s and early 1990s. Particularly when nothing in the industry has really changed. Thinking of Converting Your Marina to a Dockminium? Think Twice. by Dennis Kissman

B. Boaters concerns:

1. Owning a boat is not a necessity.
2. The decision to buy a slip for your boat is a low priority, which translates into higher marketing cost for the seller. It is easy to sell the first 20 to 30 percent of the prime slips, but what about the remaining 70 to 80 percent of slips that are not sold?
3. One of the primary reasons a person buys a boat is to be mobile. The minute a boat owner purchases a slip, some of that mobility is lost.
4. Owning a particular boat is usually not a life-long commitment.
 - a) When a boater trades a boat for another, the new boat is usually a different size. The forty-foot slip that they bought last year does not fit the beamier fifty-foot boat they have this year.
5. Does the owner have the incentive for ongoing cost savings?
 - a) Before purchasing a slip, the boater pays his slip fees. After purchasing a slip, the boater must pay property or personal taxes on the slip, interest expense on the purchase price, and monthly and special assessments for operating and maintaining the marina, plus all the other costs of owning a boat.

V. What are the marina owners' problems in selling slips?

A. First, does the marina owner have the right to sell slips?

1. Most marinas are developed on submerged leased land from the government.
 2. How does the marina owner sell something he does not own?
 - a) There have been several attempts to long-term lease the slip to run concurrent with the master lease on the marina.
 - b) The problem here is there are very few really long-term leases out there that make this a viable option for a buyer.
- B. Oftentimes, converting a marina requires a re-zoning of the property, a process that can be both costly and time consuming.
- C. Assume that the marina owner successfully re-zones the property. The rezoning usually triggers a higher property tax assessment.
1. When operated as a commercial marina, the marina was taxed accordingly.
 2. By privatizing the slips, each slip is taxed individually, and the parts usually do not add up to the whole.
- D. When a marina owner operates the marina commercially, the marina owner is the boss.
1. The marina owner sets the policies and make the decisions.
 2. The marina owner also knows how demanding some of his customers are.
 3. By privatizing the marina, the regime requires a property owner's association.
 - a) The association dictates policy for the marina in the future, not the marina owner.
 - b) What happens if the marina owner loses control of the property and still own a fair number of slips.
 - (1) We all know the condo commandos who take control of an association.
 - (2) Slip owners are also boat owners with big egos, who take control of the association.

- VI. Under the common law in most states, land abutting a natural body of water carries with it the right to use the water itself. The dockminium concept involves mainly the riparian right of access to the water for navigation.
- A. Who has the ownership right over the water?
 - B. Riparian rights do not include ownership of the bed of the sea.
 - C. Issues with navigable waters of the United States.
 - 1. Who is the proper permitting agency(ies)? If the necessary governmental permits are obtained, the owner of the riparian right has the exclusive right within its territory to wharf and moor his or her boat to the wharf.
 - 2. Unlike an easement, riparian rights in many states can be severed from the uplands to which they were originally appurtenant and can be sold to others.
 - a) For example, in New York and Connecticut, riparian rights can be subdivided by plat and rectangular portions conveyed to individuals without regard to ownership of the uplands.
- VII. Uniform Condominium Act (“UCA”) and the Uniform Common Interest Ownership Act (“UCIOA”)
- A. Creation of a dockminium depends on the form of the condominium act in the state where the dockminium is to be located.
 - 1. Creating a dockminium is easier if the state has enacted the Uniform Condominium Act (“UCA”) or the Uniform Common Interest Ownership Act (“UCIOA”).
 - a) These uniform acts broadly define the types of real estate that may be developed into common interest communities, expressly including "any estate or interest in, over, or under land ... [including] spaces that may be filled with air or water." and these specifically reference water. See Unif. Common Interest Ownership Act, §1-103(26) (1994); Unif. Condominium Act § 1-103(21) (1980).
 - 2. The UCA, the UCIOA or a version of one of these two uniform acts has been enacted in nineteen states.

3. The UCA and the UCIOA allow division of riparian rights to some degree into units and common elements and conveyed as any other interest in land.
 - a) Along the Atlantic seaboard, the states of Maine, New Hampshire, Rhode Island, Connecticut, Pennsylvania, Virginia, and North Carolina have adopted a version of the UCIOA or the UCA.
 - b) Georgia and the District of Columbia adopted a version of the Virginia Condominium Act, the predecessor to the UCA.
 - c) On the Gulf Coast, Texas and Louisiana have a severely truncated version of the UCA.
 - d) On the Pacific Coast, only Alaska has adopted the UCIOA. Washington has adopted the UCA.

B. The “Locker” Concept under Archaic Condominium Acts

1. Archaic Condominium Acts

- a) Many state condominium acts are not based on the UCA or UCIOA but are based on the FHA Model Statute for Creation Apartment Ownership of 1962.
 - (1) South Carolina is one example.
 - (2) New York, Florida, California, Illinois and Massachusetts follow old and archaic Acts as well.
 - (3) Older condominium statutes define a condominium unit as an enclosed space consisting of one or more rooms in a building. Drafting therefore requires creativity.

2. Slips as Limited Common Elements

- a) Attorneys using condominium statutes that are not based on the UCA or UCIOA have used the concept of “room in a building” by selling a storage locker or mail box in a building and attaching a boat slip as a limited common

element restricted to the use of the owner of the locker or mail box.

- b) The concept has been used in South Carolina even though South Carolina's definition of a unit or "apartment" includes a reference to "moorage of a boat." Arguably, the limited common element boat slip is a division of realty.
- c) The concept of a "room in a building" does not apply to Dry Dock or Dry Stack Condominiums

- (1) Obviously, dry stack condominiums, also know as dry dock condominiums, will not have the same issues since presumably the "units" will be located on land owned by the declarant or developer in fee and as such the units or apartments will have dimensions inside a "building" for those states having archaic condominium acts.

- 3. Proper documentation requires an examination of the size of the slip. Different boats require different size slips. It is much easier to require that all portions of the vessel be located with the unit's boundaries.

C. Restrictions on use such as renting slips to others.

- 1. Restrictions on party charter boats with accompanying parking and crowds. Are bareboat charters allowed?
- 2. Both the Uniform Acts and the FHA model provide that the declaration must contain any restrictions on use.
- 3. These restrictions cannot be contained in the by-laws or adopted by the Association board unless the slips themselves are limited common elements.
- 4. Is there a transient vessel program?
- 5. Additional consideration should be given as to the required majority for adopting any use restrictions.

VIII. Public Trust Doctrine

- A. The drafter of dockominium documents must be sensitive to the public trust doctrine.

- B. The “public trust doctrine” is another reason to use the locker concept particularly if the state does not follow the UCA or UCIOA.
 - 1. Use of the locker concept avoids conveying a fees simple interest in submerged land, water and air owned by a sovereign to a private party.
- C. Definition of the public trust doctrine.
 - 1. A Wisconsin case ruled that conversion of a marina to a dockminium violated the public trust doctrine because it transferred ownership of public waters to private individuals. See *ABKA Ltd. Partnership v. Wisconsin Dep't of Natural Res.*, 635 N.W.2d 168 (Wis. Ct. App. 2001) (holding that conversion of a marina into a dockminium development would violate the public trust doctrine because it would transfer ownership of public waters to private individuals), *aff'd* on other grounds, 648 N.W.2d 854 (Wis. 2002) (finding project in violation of state statute prohibiting transfer of riparian rights separate from the upland real estate).
 - 2. Dry stack slips do not have this problem since presumably they are located within a building facility with walls on appurtenant highland. Owners of dry stack slips need only the dockage for landing unit owner boats and fueling or other services.

IX. Financing and Title Insurance

- A. What is Being Financed and Insured?
 - 1. Financing, especially for wet slip condominiums in a state that does not follow the UCA or UCIOA but uses an archaic condominium act, can be problematic.
 - 2. The question again arises, what is a “dockminium?” An interest in land? A limited common element within a regime? A license? Is the dockminium severable from a land based condominium?
 - 3. If the dockminium is an interest in land, it is title insurable.
 - a) Generally speaking, the lender is looking for title insurance company without exception.
 - b) Lenders have gotten more comfortable financing dockminiums over the last few years.
 - 4. Questions about what is being financed and insured

- a) Does a dockminium owner really have a fee interest in square box of air and water over the sovereign's submerged lands or a quasi permit-easement right?
 - b) If a state's condominium act allows transfer of ownership, the drafter must be wary of whether a transfer is a violation of the Public Trust Doctrine since this sovereign's air and water has been transferred in fee to an individual?
5. Title Companies are wary
- a) Title insurance companies in non-UCA or UCIOA states often find dockminiums problematic.
 - (1) The locker concept may help resolve this issue to a certain degree but the lender will still mortgage the owner's unit and its exclusive use right (or limited common element) --where presumably almost all of the value is in the slip.
 - (2) Most title insurers want to insure an interest in real estate as opposed to air and water over submerged lands so the locker concept may be useful even in UCA or UCIOA states.
 - (3) Many title insurance companies now require review of the master deed or other creation instrument prior to agreeing to insure.
6. Perfection of a security interest:
- a) If a "dockminium" is sold as a right to use a slip rather than as an interest in real estate, Article 9 of the Uniform Commercial Code governs perfection of a security interest.
 - b) If the slip is sold as an interest in real estate under the condominium concept, perfection is governed by the jurisdiction's law regarding perfection of a security interest in real estate.
 - c) Should a right to a boat slip be considered as a limited common element to a unit?
 - d) Should the right to a boat slip be transferable independently of the interest in a land based condominium?

e) Ramifications for sales of hotel condominium units.

(1) Ramifications for ad valorem real estate tax purposes

X. Looking Forward: Coastal Real Estate Scarcity and Regulation

A. No two dockominium projects are exactly alike.

1. Dockominium projects often involve different combinations of commercial facilities, charter boats slips, fueling facilities and recreational users.

B. Coastal areas that have been developed or protected by state coastal acts have limited the availability of marinas and boat slips generally.

1. Limitations will only increase with coastal population increases in the future.

2. Difficulties for renters

a) Conversion projects

b) In addition, the lucrative return for developers by selling each individual slip in fee rather than selling an entire marina with leased slips will drive the continued expansion of these developments.

c) A slowdown in the demand does not appear likely with growing population of boat owners needing place to put their boat increasing the demand which will drive developers to condo marinas for the lucrative return.

XI. Industrial, Warehousing and other Commercial Condominiums

A. The Recent Boom

1. There has been a significant boom in the creation of commercial condominiums recently in addition to dockominiums. Examples include industrial, warehousing, hotel or office condominium in at some point.

2. The increase in the use of commercial condominiums has been driven by a number of factors with the two primary ones being the

recent drop in interest rates and business considerations of small and large business.

3. Condominium units can be as large 10,000 sq ft space in a massive warehouse or as small as a 700 sq ft. foot space in an office building.
4. Attorneys are being asked to assist developers in either accomplishing there goals from a return on investment standpoint or accommodating their own business by creation of a commercial condominium.

B. Business Considerations and Flexibility

1. Developer's Perspective

- a) From the Developer's perspective, the developer has the ability to subdivide and sell property that he might not otherwise be able to subdivide and sell as a separate parcel of land due to zoning or other local ordinances. There is no space too small or too large for a commercial condominium unit as long as the building in which the unit is enclosed meets local zoning or other governmental regulations. Otherwise, the developer would be limited to leasing separate spaces and not every developer wants to be landlord.---so the only other option is to the sell the entire building.

2. Purchaser's Perspective

- a) Why build when you can upfit?
- b) Interest rates have been at record lows for the last few years. This factor alone drives businesses to purchase space rather than lease. For those businesses which cannot afford to purchase space and then build, purchasing a commercial condo is the next best thing. They get many of the trappings of ownership without some of the costs. They can own a space in fee without carrying the substantial cost of building the shell and they can share some the common area costs and insurance. Additionally, they have the flexibility to buying additional adjoining space in the building and are usually not restricted to set floor plans traditionally found in residential condominium developments. Industrial and warehousing condos

generally allow their owners to “upfit” the interior space to fit the owner’s need.

3. Why Lease when you can own?

- a) Businesses are also buying commercial condominiums because they see the value in owning as opposed to leasing going forward. The fee interest will build equity for the business and may have some tax advantages over leasing (i.e., interest deductions and improvement depreciation). Additionally, leasing costs for commercial space will only increase in the future along with the material and construction costs.

4. Financing: The SBA and beyond

- a) A substantial portion of the recent commercial condo boom is from small businesses that cannot afford to buy raw land and build but don’t want to lease. There is a lot of conventional financing along with SBA loans.
- b) SBA 504 program seems to be the loan of choice for most of these businesses with 10% down by the owner, 50% loaned by the bank and 40% loaned by the SBA. Nonetheless, generally speaking many conventional commercial loans are being made and as long as the commercial condominium documents are properly drafted, there are no special concerns that the lender would that it would not have for commercial loan or a residential condo development.

5. Future Outlook

- a) The general outlook for commercial condominiums is promising when one considers increasing costs of land and construction costs.
- b) The ability of developers to sell via a condominium otherwise undividable business spaces and the affordability and flexibility of the commercial condominium for businesses should continue this trend in the future.
- c) With land acquisition costs and building costs increasing in the future, condominiums may be the most cost efficient way for many businesses to own rather than lease.

XII. Mixed-Used Condominiums and Dockominiums

A. Creation and Use

1. The same considerations driving increased development of dockominiums and commercial condominiums (i.e. land availability limitations and cost, the ability to subdivide properties and realize a significant return on investment) are driving a dramatic increase in mixed-use condominiums.
2. Rarely does a developer of dockominium project want a “plain vanilla” dockominium.
 - a) For example, most dockominium projects include a fueling dock. The regime can address issues involving the fueling dock by creating a separate regime consisting of the boat slip area alongside the fueling dock, the attendants’ shack, the pipes, the pumps and the storage tanks located on the uplands. Alternatively, the fueling dock can be a limited common element of the dockominium regime.
3. Uniform Acts permit the developer to reserve the right to develop the uplands with varying types of separately owned condominium units without subdividing the land.
 - a) If the uplands offer the opportunity to create additional saleable units that can be built or sold, the right to do so should be preserved.
 - b) Dockominium projects often include convenience stores, restaurants, hotels, ships’ chandlers, marine service shops, marine brokerage offices and repair and sales facilities.
 - c) Parking for vehicles and trailers can often be an issue.

B. “New Urbanism”

1. New Urbanism is the trend by local government and communities to allow higher density zoning and diverse uses while at the same preserving open space and promoting traditional neighborhood development or smart growth.
 - a) The New Urbanism has spurred continued growth in mixed use projects nationwide.

- b) In the context of dockominiums, one must ensure that all competing interests such as between slip owners and the owner of other commercial properties are balanced.

2. Mutual Benefit

- a) Developments using the New Urbanism strategy provide synergy between hotels, retail businesses and residential units.
 - (1) Retail businesses have a built-in client base and the residential owners have convenient access to the commercial units business. These like other condominium concepts can be new construction on land acquired from the developer or the conversion of existing building which they make fit their project.

3. Balancing Interests

- a) When drafting condominium documents for mixed-use projects, one must balance the interests of both the commercial owners and the residential owners.
 - (1) Voting rights and common area use and/or access easements are areas of significant concerns when drafting.
 - (a) Budgets for dockominium projects and their associations generally need to include standard residential budget items as well as dockmasters' salary; maintenance dredging (where will the spoil go and other permitting issues); laundry; showers; restroom maintenance; communications systems (radio and ship-to-shore charges); lift operations; piling and pier winterizing and spring resetting and replacement from ice damage; flood and hurricane insurance; and other seasonal and regular service that need to be provided as common expenses.
 - (b) Need for appropriate reserves for dredging; steel bulkheads and fittings; marine rot (barnacles and other lovely sea creatures); the corrosive effect of wave action; and the

general replacement of piling and dock structures.

- (2) One must ensure the proper balance in voting and decision making.

4. Compatibility Between Commercial and Residential Units

- a) The compatibility between residences with the businesses will also be a major concern.
- b) The advisability of separate regimes. If the project will include dockominiums, retail businesses and luxury residential units, one must examine the markets to whom these units will be sold. Often, residential units or hotel condominium units should be luxury or higher end.
 - (1) For example, an interesting mix would include a checking cashing service located below residential units costing over a million dollars each or night clubs playing loud music into the wee hours of the morning located below residential units
 - (2) Proper drafting of regime documents can insure marketing desirability and prevent problems later.

5. Benefits of Proper Design

- a) The benefits of proper design are many but two key ones are
 - (1) minimizing problems between the residential and commercial unit owners in the future; and
 - (2) Sales and marketing
 - (3) These potential issues can be managed in the restrictions. More complex project will require more careful drafting. One cannot foresee everything--but some taking into account compatibility issues when designing a project will minimize later headaches for the condominium owners' association.

XIII. "Hotel Mixed-Use Project" One of the hottest trends right now in mixed-use developments is the hotel mixed-use concept.

A. Hotel Branding and the Branded Manager

1. The concept is whether the construction is new or a conversion—the developer-owner usually owns the hotel and creates a regime for sale of the residential units.
 - a) The owner will then bring in a management company or a “branded” third party manager that owns a hotel brand (i.e. Ritz-Carlton, Westin, Hyatt or Four Seasons) and operated hotels under that brand which are generally luxury or high-end hotel brands.
 - b) The branded manager will manage the hotel and license other branded amenities (health spa, golf course, salon, etc.). Hotel guests and the public generally perceive the project as a Ritz-Carlton or other high end hotel.
2. Management Contracts
 - a) The branded manager will have a very detailed management contract that will generally stipulate that the manager is paid on a percentage of gross sales with incentives. As with any hotel management contract, these contracts will include numerous provisions to insure that the hotel owner does not do anything to damage the brand name.
 - (1) For example, the developer will use this “hotel branding” to help sell the residential units as luxury units with --Ritz-Carlton services. The management contract will generally have provisions specifying what representations may be made to purchasers of residential units.
3. Residential Units in Rental Pool
 - a) The regime documents can provide the residential owner can opt to have their units included in the pool of rooms for rent by the hotel through the branded manager. The residential owners will receive rent less a management fee and other costs. Generally, the split in the management fee leads to the hotel rooms being rented first with the residential units serving as a second option.

- b) The hotel brand generally will also brand the residential units with a contract or license allowing the developer owner or its agents to market the property under the brand.—this can benefit the hotel brand and residences alike since the residences are associated with a quality brand and the brand is perceived as having a greater number of product and services.

4. Financing and Insurance

a) Senior and Mezzanine Debt

- (1) Larger projects often involve “senior debt” (debt with a 1st lien position) and “mezzanine debt” (debt used to cover the difference between the borrower’s equity contribution and the Senior Debt).

- (a) Mezzanine debt may or may not be secured with a junior lien depending on the position of the Senior Debt lender.

- (b) Depending on the position of the Senior Debt holder and the terms of those loan documents, Mezzanine Debt may be secured by pledge of the equity interest in the borrower.

B. Future Outlook

1. Coexistence of Commercial and Residential Inevitable

- 2. Future population increases, the growing interest of local authorities in zoning requiring more open space or green friendly neighborhoods and the push for New Urbanism are increasing the interest in mixed-use projects. Mixed use projects allow developers to design a diverse project that creates benefits to the developer, residential owners and the commercial owner. This population expansion and the resulting land scarcity will bring these concepts to the forefront as a creative way for developers to design a project for businesses and residents to co-exist.

3. Risk to Residential Units

- a) Synergy works both ways. The drafter must consider the risk to residential owners if the commercial units go out

of business since it may difficult to bring in a new businesses or operator.

- (1) This concern is especially true in the hotel mixed use development where the closing of the hotel could seriously impact the residential unit values since they are tied to the brand. If a different brand locates in the hotel, the impact on residential units can be substantial.