Keeping the family cottage in the family

The family cottage often holds fond memories of our youth and time together as a family. Unfortunately, the family compound is often lost at the death of parents.

Without a plan to sustain the cottage over the next generation, and perhaps beyond, most parents simply leave their vacation home to their children without further direction. Children, wishing to avoid the inevitable squabbles over usage, maintenance, and holding costs, soon sell Shangri-La and split the cash.

Mom and dad would certainly roll over in their celestial canoe if they knew.

It's ironic that total strangers can share property in the form of time shares and fractional interests while most families find any form of sharing unworkable. Certainly, feelings run higher in families, but with a little planning the family cottage can be kept in the family for decades or even generations.

The Kennedy's have Hyannisport and the Bush's have Kennebunkport, but you don't have to be rich to enjoy a permanent family retreat. The key is to establish a limited liability company (LLC) to own the property, and then adopt an operating agreement that details the rules of sharing usage, expenses, and maintenance.

It would also be advisable to allocate a few years of taxes and maintenance to the LLC, which could be funded by life insurance, to help in the transition from a parent-run to a children-run operation.

A LLC offers many advantages over direct ownership. Instead of owning real estate, family members own membership units in the LLC. The LLC, in turn, owns the vacation property, furniture, and possibly recreation vehicles and boats.

The Kennedy family--Carolyn, John, Jackie, and John Jr. —at the clan's cottage at Hyannisport, Massachusetts.

The rights and duties of the owner/members are thus governed by the agreed-upon laws of the LLC as set forth in the operating agreement, rather than by the rigid laws of real estate ownership.

In addition to setting forth the rules of operation, the LLC also shields members from personal liability for injuries sustained on the premises; which is no small benefit in light of the wild and crazy behavior that often takes place on the lake, the trails, and around the fireplace.

The LLC can also frustrate an outside creditor's attempt to seize a member's interest in the property, thereby keeping the cottage "in the family." For example, a call option can be written into the LLC operating agreement that would prevent an in-law from acquiring a family member's membership interest by divorce.

Let's face it; nobody wants to roast marshmallows with Aunt Amy's new ex-convict boyfriend.

The LLC operating agreement can address the issue of a family member who wishes to dispose of his or her interest.

Without an LLC, an heir holding a joint interest in the cottage could force the sale of the cottage under a legal action for partition. The court would force the sale of the vacation property and divide the proceeds among the owners.

If mom and dad left the cottage to children as tenants in common (as opposed to joint tenants with rights of survivorship), each child would be free to sell his or interest to non-family members; perhaps the Hells Angels are looking for a clubhouse in your area.

Instead, the LLC operating agreement prevents partition by establishing the procedures for buying out a member looking to dispose of his interest. The agreement can provide the price, procedure, and terms of the buyout.

The operating agreement can address a member's failure to meet his financial obligations to the LLC. Options may include an interest bearing loan, loss of right to use the property, a fine, or even the forced sale of the member's share.

An LLC can operate by majority rule, or the members may elect a manager to carry out day-to-day business of the LLC. If a manager is preferred, procedures for electing and removing the manager, as well as the term, rights, and duties of the manager can be outlined in the operating agreement.

Even where a manager is elected, all members typically must approve major decisions such as the selling, mortgaging, or improving of the cottage.

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The highly emotional issue of usage can easily be addressed in the operating agreement. Holidays and desirable weeks can rotate among members annually. Once allocated, members are free to either trade or buy weeks from each other based on their needs. It may also be desirable to allocate one week--like the week of the 4th of July, Memorial Day, or New Years Eve week--for communal use of all members.

Rules can be established with regard to rental to outside members. Outside rental can either be allowed or prohibited. If allowed, a percentage of the rent or a flat fee should be allocated to the LLC to compensate all members for the wear and tear associated with rental.

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Keeping the family cottage in the family is a way of perpetuating family ties and identity. With a little planning--including a cottage LLC and its accompanying operating agreement--all family members can enjoy equitable use of the family compound.

Properly done, a cottage LLC can even be an excellent long-term investment (notwithstanding the current downturn in the real estate market) as vacation homes continue to bring a premium return on investment.

If you own a treasured vacation home of any value, and wish to perpetuate family unity, consider creating a cottage LLC. Advise your children of your intentions. A good test of the viability of your plan will be how they respond to your idea and whether they can participate in the discussions thoughtfully and without conflict.

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