

**Yours, Mine and Ours:  
Co-Tenancy Agreements**

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## **YOURS, MINE AND OURS: CO-TENANCY AGREEMENTS**

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## **I. WHAT IS A CO-TENANCY AGREEMENT AND WHY WOULD MY CLIENT WANT ONE?**

“Co-tenancy agreements” provide a contractual relationship to acquire, enjoy and ultimately dispose of property. These contractual agreements may provide for equal or unequal financial contributions by the parties; provide terms and conditions for day-to-day management; detail possessory rights and provide terms applicable to disintegration of the relationship between the parties. Essentially, these “rules of engagement” allow a court specific basis for jurisdiction in resolving disputes arising between/among the parties. A properly drafted co-tenancy agreement which addresses and balances the respective interests of the owners will provide a legally enforceable mechanism for dispute resolution and for disposition of the real property without involving the significant cost and delay incidental to a partition action.

## **II. TYPICAL ISSUES.**

### **A. Property Types.**

- i.** Structures with two or more exclusive spaces, such as an upstairs/downstairs duplex or a home with a mother-in-law” apartment.
- ii.** Structures with fully-integrated living spaces shared by two or more parties, such as a traditional single-family residence.
- iii.** Recreational properties (including lake cabins) which are used exclusively by each respective party at different times.
- iv.** Properties acquired for investment purposes.

### **B. Parties.**

- i.** Roommates.
- ii.** Unmarried “involved” partners.
- iii.** Elderly parent living with adult child.
- iv.** Multiple or extended families.
- v.** Parties pooling resources (e.g. to assist one party with a purchase that the party could not qualify for independently).
- vi.** Participation solely for investment purposes.

### **III. DRAFTING, IMPLEMENTATION AND TERMINATION ISSUES.**

#### **A. Relationship of Parties/Purpose for Sharing Property.**

##### **i. Financial Considerations.**

1. Typically the parties are jointly and severally liable for a mortgage over an extended period of time.
2. Documentation of equal/unequal down payment contribution.

##### **ii. Personal Considerations - Compatibility.**

1. Length of time parties have known each other.
2. How well do the parties really know each other.

##### **iii. Anticipated length of time property will be shared.**

#### **B. Defining Possession and Use Terms.**

##### **i. Access.**

##### **ii. Common areas.**

##### **iii. Exclusive private areas.**

##### **iv. Limited common areas.**

##### **v. Visitors/entertaining.**

##### **vi. Pets.**

##### **vii. Personal property (including phone, cable TV, internet).**

##### **viii. Parking.**

#### **C. Special Allocation Issues.**

##### **i. Sweat equity.**

##### **ii. Owners' association vote.**

##### **iii. Insurance/liability.**

#### **D. Tax and Finance Issues.**

##### **i. Real Estate Taxes - Homestead Qualification.**

1. Occupancy is required to claim the homestead real estate tax rate. For example, if a principal residence occupant party under a co-tenancy agreement has an 80% ownership interest, only 80% of the property's value will be taxed at the homestead rate. Note also that in certain circumstances (e.g., where the non-occupant owner is a parent, child or other qualifying relative under Minn. Stat. § 273.124, Subd. 1(c)) 100% of the property can be homesteaded even though one or more owners do not occupy the property as their principal residence.
2. Where all parties to the co-tenancy agreement use the property as a principal residence, 100% of the property's value is taxed at the homestead rate.
3. Partnership owners cannot take advantage of the homestead rate.

**ii. Expenses and Deductions.**

1. Allocation based on percentage ownership.
2. Allocation based on incomes/tax brackets involved.
3. Allocation based on use.

**iii. Taxation of Gain at Sale.**

1. Individual party owners.
2. Entity as property owner.

**iv. Credit Reporting.**

**E. Maintenance and Improvements.**

- i. Capital improvements.
- ii. Maintenance and repair.
- iii. General upkeep (lawn care, etc.).

**F. Dispute Resolution.**

- i. Negotiation.
- ii. Mediation.
- iii. Arbitration.

**iv.** Litigation.

**G. Termination of Agreement.** All co-tenancy agreements should address the terms, conditions and circumstances under which the parties may terminate their future rights and obligations under the co-tenancy agreement.

**i.** Buy-Sell.

**1.** Relationship ends.

**2.** Job transfer.

**3.** A party fails or is unable to meet its financial obligations.

**4.** A party seeks to acquire 100% interest in the property.

**ii.** Liquidation and division of assets.

**iii.** Death and/or disability of an owner.

**iv.** Marriage dissolution.

**v.** Marriage of the parties.

## CO-TENANCY AGREEMENT

THIS AGREEMENT, made and entered into effective the 1<sup>st</sup> day of November, 2004, by and between **John Smith** and **Mary Smith**, husband and wife as joint tenants (hereinafter individually and collectively referred to as "Smith") and **Sarah Anderson**, a single woman (hereinafter referred to as "Anderson"). Smith and Anderson collectively are herein referred to as the "Parties"<sup>1</sup>.

### WITNESSETH:

**WHEREAS**, the Parties have acquired property in the County of Ramsey, State of Minnesota, legally describes as follows:

#### **Lot 1, Block 1, Blackacre Addition to Saint Paul**

(the "Property"); and

**WHEREAS**, the Parties purchased the Property for a consideration of Five Hundred Thousand and 00/100 Dollars (\$500,000.00); and

**WHEREAS**, certain closing costs were incurred in connection with the acquisition of the Property in the amount of Ten Thousand and 00/100 Dollars (\$10,000.00); and

**WHEREAS**, the Parties jointly contributed to the Property certain labor commonly referred to as "sweat equity,"<sup>2</sup> which labor collectively was in the amount of \$5,000.00; and

**WHEREAS**, the Parties are jointly and severally liable on a Purchase Money Note and Mortgage in the amount of Four Hundred Thousand and 00/100 Dollars (\$400,000.00); and

**WHEREAS**, the Parties agree that the reasonable value of the Property as of the date hereof is Five Hundred Twenty Thousand and 00/100 Dollars (\$520,000.00)<sup>3</sup>; and

**WHEREAS**, it is the intention of the Parties that the Property be considered a capital asset of Smith equal to a sixty percent (60%) ownership interest in the Property<sup>4</sup>; and

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<sup>1</sup> Where the parties consist of two or more families, we suggest examining title before the drafting process in order to determine whether any restrictive covenants encumbering the property limit the number of families per residential structure, prohibit garages the size desired to accommodate all vehicles for the families, etc.

<sup>2</sup> This can often be a point of contention when an ownership relationship "unwinds" and should be carefully reviewed with the parties in terms of the work contributed and the value to be placed on the various types of contributions.

<sup>3</sup> Setting the initial value acceptable to each party is easily glossed over given the annual agreed-upon adjustment in value included in most co-tenancy agreement (see Section 6 below). However, an accurate initial number is crucial where the co-tenancy dissolves earlier than the first annual valuation adjustment. In addition, setting the initial value can be challenging where a co-tenancy is created after the property has enjoyed a significant appreciation or where the parties have acquired the property at below market value and are expecting a large initial appreciation.

**WHEREAS**, it is the intention of the Parties that the Property be considered a capital asset of Anderson equal to a forty percent (40%) ownership interest in the Property; and

**WHEREAS**, it is the intention of the Parties to this Agreement that the Property will be used exclusively for residential purposes by Smith and Anderson.

**NOW, THEREFORE**, it is agreed between the Parties as follows,

1. **Possession.** As tenants in common, Anderson and Smith jointly and severally have the right of possession in and to the entire Property. Notwithstanding the co-tenancy of Anderson and Smith, possessory rights to the Property have been allocated between the Parties as follows:
  - a. Anderson shall have the sole and exclusive right of possession to the ground floor residential living area commonly known as 800 Blackacre Street, St. Paul, Minnesota 55103, which area consists of approximately 1,500 square feet (the "Anderson Unit").
  - b. Smith shall have the sole and exclusive right of possession to the upper floor residential living area commonly known as 810 Blackacre Street, St. Paul, Minnesota 55103, which area consists of approximately 1,000 square feet (the "Smith Unit").
  - c. Smith and Anderson shall have joint and several right of possession and use of the following portions of the Property (collectively, the "Common Area")<sup>5</sup>:
    - i. Basement area.
    - ii. Yard areas.
    - iii. Double framed garage.
    - iv. Driveways and walkways.
    - v. Exterior deck areas.
  - d. Smith and Anderson respectively shall also have the following limited right of access over the following portions of the Property:

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<sup>4</sup> Where the parties are not contributing equal capital and sweat equity, each will want to carefully consider what % contribution is acceptable to them, bearing in mind that the division of capital/sweat equity typically will determine the division of tax benefits (as detailed in Section 14 below). This is of course a delicate balancing act where the available assets and/or tax brackets of the parties are significantly different.

<sup>5</sup> It is worth taking the time to review in detail with clients not only the spaces to be considered part of the Common Area but also how those spaces may be used.

- i. Smith is entitled to access to the upper unit entryway located on the ground floor level of the west side of the dwelling.
  - ii. Anderson is entitled to access and use of the back upper deck accessed via the outside spiral staircase.
2. **Expenses.** During the term of this Agreement, the following expenses of the Property shall be shared between the Parties in the same ratio as the ratio of the Parties' ownership (i.e., 60% and 40%)<sup>6</sup>:
  - a. Monthly obligations for principal and interest on the first mortgage against the Property.<sup>7</sup>
  - b. Real estate taxes and special assessments against the Property as required by state law or in the manner specified in any underlying financing documents.
  - c. Homeowner's<sup>8</sup>, fire, hazard and public liability insurance for the Property.
  - d. Costs for maintenance and repairs to the Property, except as required within the Anderson Unit and/or Smith Unit.
  - e. Capital improvements to the Property, provided that such improvements have been authorized in accordance with the terms of this Agreement.
  - f. Repair and maintenance of equipment and appliances located within the Common Area including but not limited to fixtures which provide service exclusively for the Smith Unit and/or Anderson Unit (furnaces, water heaters, central air conditioning units, etc.).
  - g. Repair and maintenance of Common Areas, including but not limited to the exterior areas of the residential dwelling, such as roofs, decks, porches, walkways, drives, detached garage and yard areas.
  - h. Repair and maintenance of heating, electrical and plumbing distribution lines within the Common Area.
  - i. Lawn maintenance and snow removal.

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<sup>6</sup> In the event that one party wants to pay, or is forced to pay, a portion of the other party's payment obligations, the question arises as to if (and when) such payment erodes the under-paying party's percentage interest in the property. Delinquency issues are addressed in Section 9 below.

<sup>7</sup> A suggested addition in language in terms of general housekeeping would be to specify which party will actually handle mailing the mortgage payment to the mortgage company.

<sup>8</sup> The parties will want to carefully consider the scope of personal property insurance coverage if the value of their personal property differs significantly.

Notwithstanding the foregoing allocation, the following shall be applicable:

- j. Anderson shall be solely responsible for repair and maintenance within the Anderson Unit.
  - k. Smith shall be solely responsible for repair and maintenance within the Smith Unit.
  - l. Anderson shall be solely responsible for all utilities provided to the Anderson Unit, including water, gas and electric service.
  - m. Smith shall be solely responsible for all utilities provided to the Smith Unit, including water, gas and electric service.
  - n. A Party causing damage to the Property as a result of their negligence shall, to the extent the damage is not covered by insurance, be solely responsible for the cost of the repair, regardless of the location of the damage, required as a result of their negligence.
3. **Personal Property and Fixtures.** Personal property within the Anderson Unit shall be the sole and exclusive property of Anderson.<sup>9</sup> Personal property within the Smith Unit shall be the sole and exclusive property of Smith. Notwithstanding the foregoing, the following fixtures located within the Common Area are assets which shall be repaired, maintained, insured and replaced in accordance with paragraph 2.f. of this Agreement:
- a. Furnaces.
  - b. Water heaters.
  - c. Central air units.
  - d. Water softeners (if any).
4. **Term.** The term of this Agreement shall commence as of the effective date first stated above and shall be effective and binding upon the respective Parties for such period of time as they have an ownership and/or liability in regard to the Property.
5. **Restrictions.** It is agreed that the following acts shall require unanimous consent<sup>10</sup> of the Parties:

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<sup>9</sup> Complicated questions obviously can arise upon dissolution of the co-tenancy when the parties wholly share possession of the property and consequently co-mingle a large number of personal items. The parties may want to consider attaching an inventory of each party's personal items (at least those of greater value) as an exhibit to the Agreement. It is also advisable to include a section in the Agreement regarding how personal property that is purchased together is to be valued, and how it is to be divided in the event the co-tenancy is to be dissolved.

<sup>10</sup> A percentage consent less than unanimous percentage may be advisable if the property is owned by more than two

- a. Creation of any encumbrance against the Property.
- b. Any lease agreement regarding all or a part of the Property.
- c. Compromise of any claim, dispute or controversy involving the Property.
- d. Making of any improvement to the Property which would be deemed a capital improvement rather than a repair expense if the Property had been utilized for rental property.
- e. Repair, maintenance and replacement of fixtures, the estimated cost of which exceeds \$3,000.00.

6. **Valuation.** The value of the Property for the purpose of this Agreement as of the effective date hereof is \$520,000.00. The Parties agree to redetermine the value of the Property and the resulting value of their respective interests within sixty (60) days following the end of each calendar year, commencing with the calendar year ending December 31, 2005. The value so agreed upon shall be endorsed on Schedule A attached hereto and made a part of this Agreement. Endorsement shall take the following form:

The undersigned mutually agree that on this \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_\_, for the purpose of the foregoing Agreement, the Property has a value of \$\_\_\_\_\_. The interest of the respective Parties in the Property has the following value:

|                   |          |
|-------------------|----------|
| Smith Interest    | \$ _____ |
| Anderson Interest | \$ _____ |

If the Parties fail to make a redetermination of value for a particular year, the last previously stipulated value shall control, except that if they have not so redetermined the value within eighteen (18) months immediately preceding the death of a Party and/or the issuance of a Right of First Refusal, the value of the withdrawing Party's interest shall be determined by appraisal. Each individual or his or her successors, heirs and assigns, shall name an appraiser. The remaining Party shall also name an appraiser. If the two appraisers cannot agree upon a value within thirty (30) days, they shall appoint a third appraiser and the decision of the majority shall be binding upon the Parties. All fees for appraisal will be shared equally by the Parties.

7. **Right of First Refusal and Inter-Party Sale.** Each Party shall have the Right of First Refusal to purchase the other Party's interest in the Property.<sup>11</sup> In the event that either Party seeks to dissolve the common ownership of the Property by sale of their respective

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parties.

<sup>11</sup> Consideration must be given here to the interplay between the exercise of this right and any "due on sale" clause included in a mortgage or other financing instrument.

interest therein, said Party must give written notice of such intent to the other Party. If the receiving Party wishes to purchase the Property, he or she must give written notice of intent to purchase the Property within thirty (30) calendar days of receiving said notice or this Right of First Refusal is deemed waived. The value of the Property shall be as determined by Section 6 above. The terms for purchase shall be as follows:

- a. In the event a Party exercises its Right of First Refusal as a result of the death<sup>12</sup> or incompetency of the other Party, the purchasing Party shall be entitled to assume the existing financing and other debt obligations against the Property without securing a release of liability for the selling Party. The difference between the value of the Property (less normal and customary closing costs and the encumbrances assumed) multiplied by the selling Party's percentage interest in the Property shall constitute the equity of the selling Party. The equity being purchased shall be paid twenty percent at the time of closing and the balance shall be amortized with interest at the same rate of interest as called for in the Purchase Money Note and Mortgage referenced in this Agreement, to be paid in equal monthly installments over a term of twelve years with a maturity date three years from the date of closing.
- b. In the event a Right of First Refusal is exercised due to the fact that a Party has determined that he or she wishes to withdraw from ownership of the Property, the individual exercising the Right of First Refusal shall be entitled to assume the mortgage only if a release of liability is obtained for the selling Party or in the event the mortgage balance does not exceed seventy percent (70 %) of the then-established value for the Property. Only encumbrances for which the selling Party has no personal liability may be assumed by the purchasing Party.
- c. Real estate taxes shall be prorated to the day of closing with each Party paying their portion of the amount attributable to the pre-closing portion of the tax year. The balance of the taxes shall be assumed by the purchasing Party,
- d. Unless assumed as an encumbrance in accordance with the subsections above, all special assessments shall be paid in full at closing.
- e. Closing shall occur not more than ninety (90) days from the receipt of the notice of Right of First Refusal.
- f. If the existing mortgage is paid in full at the time of sale to the purchasing Party, all mortgage charges, including but not limited to any prepayment penalties, shall be shared by the Parties in the same ratio as their ownership in the Property.
- g. All costs of sale, including but not limited to closing fees, shall be shared by the Parties in the same ratio as the ratio of their ownership of the fee interest in the Property. Each Party shall pay his or her own attorney's fees. Recording fees,

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<sup>12</sup> For parties with a child or children from a prior relationship, the parties will want to consider inheritance rights when negotiating this term.

