Accepting Real Estate: Real Life Scenarios

Colorado Planned Giving Roundtable 28th Annual Summer Symposium

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Session Objectives

- Recognize real estate gift opportunities
- Understand the risks to your institution and how they can be minimized
- Learn to manage donor expectations

Greater confidence in securing real estate gifts
Types of Property

- Residential
  - Owner-occupied or rental

- Vacation property

- Undeveloped land

- Industrial

- Commercial
  - Office or retail

- Agricultural
Gifts of Real Estate

Note: Based upon data collected and analyzed by Kaspick & Company and its experience in working with clients.

Challenges
Complex; involve some risk; require time, expertise, and effort

Rewards
More gifts; larger gift sizes; “success breeds success”
Median Gift Asset Values: Trusts

Cash: $100,000
Real estate: $400,000
Securities: $147,005
Other: $319,630

Note: Median gift size for all new trusts created 2005–2015
Why Donors Fund Life Income Gifts with Real Estate

**Motivations**
No longer want to manage property
Personal reasons necessitate move
Right buyer has come along
Campaign gift
Do not foresee further appreciation

**Planning Objectives**
Avoid capital gains tax
Increase income
An outright gift is too much
The Real Estate Gift Process

1. **Discovery & qualification**
   - 1. Understand donor motivations
   - 2. Analyze the property

2. **Gift structuring**
   - 3. Develop the gift plan
   - 4. Accept the gift

3. **Gift execution**
   - 5. Fund the gift
   - 6. Manage and sell the property
   - 7. Administer and invest the gift
What Are the Challenges?

- Lack of expertise
- Screening out bad proposals
- Managing many issues simultaneously
- Overcoming institutional reservations due to previous bad experience(s)
- Overcoming organizational inertia and generating energy for an uncommon gift
Who Can Help You?

Real estate specialist on staff

Your legal counsel

Trustees, volunteers, friends

Network of brokers, appraisers
Preferred Vehicle: Flip Unitrust

Net Income Unitrust

- Donors
  - Contribute property to the trust

- Charity trustee
  - Distributes net income (if any) to the beneficiary
  - Markets and sells the property
  - Invests trust assets following the sale

Standard Unitrust

- Charity trustee
  - Invests trust assets
  - Distributes fixed percentage of the annual market value to the beneficiary

Trust "flips" January 1 following property sale
Scenario: Flip Trusts Funded With Real Estate

In January, Kevin funds a 6% flip unitrust with commercial property yielding 8%. The property sells in late March.

Kevin receives his second payment at the end of June and is very disappointed.

What happened?
Timing Issue

March 18, 2015–December 31, 2015
Period of lower net income payout

October 11, 2015–December 31, 2015
Period of lower net income payout
Good Practices

- Educate the donor about:
  - The mechanics of the trust
  - Income levels during the pre-flip period

- Manage the donor’s expectations

- Consider which trust provisions to include:
  - Define income to include post-gift capital gains
  - Include a make-up provision
  - Give the trustee discretion to allocate expenses to income or principal
  - Include short-term gains distributions as income
Interest Rates Drive Income Distributions

As of 12/31/10:
- 30-Year Treasury: 4.4%
- 10-Year Treasury: 3.3%

Source: Federal Reserve.
Alternate Vehicle: Gift Annuity

1. Donor
2. % off
   Annuity rate usually discounted to reflect lack of liquidity and selling costs
3. Charity
4. $$$$ 
   Typically deferred
   Prior to sale, charity must fund payments and possibly the state reserve account
Using a Gift Annuity Instead of a Flip Unitrust

Simpler for the donor

Sometimes an annuity payment is more appropriate for the donor

Higher risk for the charity

More difficult gift acceptance process

Accuracy of property evaluation and assessment of marketability is more critical
Risks for Your Institution

- Lack of liquidity (cash flow)
- Condition of the title and the property
- Environmentally liability
- Lack of marketability
- Reputation
How Can You Reduce the Risks?

- Gather and analyze key information early
- Ask the donor to serve as trustee
- Thoroughly review the property
- Actively manage donor expectations
- Draw on your resources
Screening Out Bad Gifts
Issues to Cover in the First Contact

- Type and use of property
- How the property is titled
- Estimate of property value and marketability
- Whether there is any debt
- Ask for copies of
  - Deed granting property to donor
  - Most recent tax bill with assessed valuation
Addressing Marketability Concerns
Before the Gift

- Defer the gift until the market improves
- Be alert to unusual property characteristics
- Perform your own market analysis
- Use more conservative assumptions when evaluating real estate gifts made in return for annuity payments
- Make sure the donor has reasonable expectations
Addressing Marketability Concerns
Before the Gift

- Discuss the range of outcomes each party is willing to accept
- Pre-negotiate the sale (charity only)
- Consider using a “charitable put”
- Ask the donor to serve as initial trustee
Donor as Initial Trustee: How It Works

- **Develop gift plan**
- **Execute trust agreement**
- **Draft the deed**
- **Manage property**
- **Market property**
- **Negotiate sale**
- **Donor resigns**
- **Charity becomes trustee**
- **Outside manager (if applicable)**

Colored boxes represent activities for which the donor is solely responsible.
Addressing Marketability Concerns
After the Gift

- Be patient
- Rent the property
- Address property deficiencies
- Lower the price
- Consider seller financing to assist in a sale
- Auction the property
Addressing Cash Flow Concerns
Before the Gift

- Complete a detailed cash flow analysis, including worst-case scenarios
- Secure a donation of liquid assets up front
- Set donor expectations about ongoing contributions; execute a letter of understanding
- Explore the possibility of renting the property; discuss with the donor
Addressing Cash Flow Problems
After the Gift

- Help the donor consider alternative ways to fund an addition
- Rent the property
- Create a working capital reserve
- Charity buys part of the property
- What about the trust borrowing money?
Discussion Questions

1. What are the primary issues you identify?
2. What additional questions would you most like to ask?
3. What gift options might you explore?
4. What fundraising strategy issues or questions do you see?
5. What institutional risk issues might arise?

These cases are derived from actual situations, but they are presented for illustrative purposes only. Based on individual facts and circumstances, your results may differ. The cases do not represent tax or legal advice.
Hi, my name’s Marty. I’m a 50th reunion donor from Alabama. I’m interested in creating a life income gift of real estate.
You Reap What You Sow

My attorney has prepared a trust instrument naming your institution as trustee, and he is ready to deed the land to the trust.

80 acres of Illinois farmland appraised at $892,000
Additional Facts

- Oral rental agreement with two brothers ($24,000 income last year)
- Prospective buyer offering premium price if tenant-free
- Land inherited over time from grandfather, mother, and aunt
- The brothers are preparing the land for next year
Marty’s Flip Unitrust: Funded in October 2015

- 80 acres of farmland
- Trust
- Income for life
- College agreed to serve as trustee
- Trust remainder
- College

Lease Termination Agreement

a. Trustee agreed to a buyout of the lease and reimbursement for fertilizer from sale proceeds

b. Neighboring farmer purchased the farm in March 2016