Family Enterprises and their Real Estate

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Introduction

Family controlled real estate may be the primary or most valuable asset of a family business enterprise. Real estate (or property as it is sometimes called) is different in material ways from other asset classes. And family owned or controlled real estate differs in material ways from real estate with non-family ownership. To think about and optimize value of their real estate, family owners and their advisors need to figure out what the family has (whether it is part of their core business, used in connection with their business or serves another purpose). They need to analyze each asset both individually and as part of a whole, and then they should make considered short and long term decisions on management of the family's entire real estate portfolio.

Analysis of family real estate assets includes more than standard real estate analyses. For family controlled real estate, analysis of the goals of family members and family units within the family shareholder control group as well as the goals of family controlled operating companies which have interests in or occupy the family controlled real estate, is extremely important. Those analyses enable decision makers in the family control group to: (1) identify goals, risk tolerances and likelihood of conflict: (2) balance the interests and deal with conflicts among interest holders; (3) make effective short and long term decisions, addressing interests of non-controlling family owners and avoiding expensive and destructive disputes between and among family ownership groups. If the family has common goals and a culture which permits discussion of difficult issues, it can also reach agreement on a governance system which establishes family controlled real decision making systems that address family financial and non-financial goals, acknowledging family culture and member interests while at the same time providing for effective management of each asset and the portfolio as a whole.

Independent advisors, professionals and experts are essential in understanding the family real estate, its development and its management opportunities. They also play crucial roles advising families with respect to ownership, acquisition, and disposition of family real estate assets. They have the distance from family emotions to provide impartial opinions and are more reliably credible than family members when they assert those opinions. Independent advisors also are helpful is establishing and implementing family goals and strategies, not only because they tend to be impartial and credible, but also because they have an understanding of the family and relationships with family members. They are critical to the process of reaching a Family Agreement which works over time.

Finally, family history often plays a major role, consciously or otherwise, in decision making for certain properties. Understanding the story lines for these properties and considering them in establishing goals and strategies, improves the quality, effectiveness and family acceptance of decisions about these properties. Such skills and the emotional intelligence may help executives and advisors to other forms of privately owned businesses, but nowhere are such aptitudes and expertise as essential as when dealing with family controlled property.

Family Owned and Controlled Real Estate Assets Present Opportunities and Challenges

Families, and enterprises they control, own real estate interests in many different contexts:

- Family real estate businesses (real estate development, management),
- Real estate used by family businesses (retail, commercial, manufacturing, industrial)
- Other business real estate (income producing)
- Real estate used by family members (non-business related, sometimes with shared ownership by extended family)
- Combination(s) of the above

Challenges and opportunities relating to family real estate differ materially from those presented by a family controlled operating company. Ownership structures separating control from income or equitable ownership are available, allowing for sophisticated tax planning and governance systems not as readily available to owners of operating companies held in corporate form. Limited liability companies can provide property owners with a variety of opportunities for customized structuring arrangements. Some forms of entity permit nuanced input from owners who are not involved in operations/management of real estate assets. Tax systems in some jurisdictions provide options for real estate that are not available for other types of assets and businesses. Consequently, tax considerations are more powerful inputs to decision making with respect to real estate than in other types of businesses.

Ownership continuity rather than management succession may dominate family concerns regarding the real estate the family controls. Property management is often a secondary priority. Family members with ownership interests often insist on a greater voice in decision making in real estate than in manufacturing, retail or distribution companies. However, the financial and legal knowledge required for decision making in areas such as entity choice, financing, development, and improvement require input from expert professionals and consultants. Real estate can be the focus of strong emotions (for example, relating to family vacation property or the family homestead, which are the locus of family history, legacy and shared extended family experiences). The family may view its real estate as secondary or inconsequential – even when, in fact, it constitutes a family's most valuable asset.

Paradoxically, families may view governance issues as unimportant or irrelevant in the context of their real estate assets. But for all the reasons recited above (and more), in fact it is critical to establish clear, accepted systems of decision making relating to the family real estate portfolio and specific real estate assets. Without such systems, the use, value and returns for assets in the portfolio may be or become disorganized, internally contradictory, counterproductive and, most unfortunately, the source of intra-family conflict. Disputes relating to family controlled real estate can be and often are as divisive and expensive as disputes relating to any operating family business.

Families who are not in the real estate development or management business generally do not think of themselves as being "in the real estate business," even when they have varied and extensive real estate holdings. Consequently, they may not manage their real estate interests as a group of assets – a real estate portfolio. In fact, even sophisticated business owning families frequently fail to apply the same level of expertise to management and ownership of real estate as they do to the operating company that may occupy the real estate the family owns. However, real estate is a unique class of assets and real estate portfolios have certain distinctive characteristics in common, irrespective of who owns them, and owners who ignore these realities do so at their own peril:

- Real estate is tangible. Asset locations cannot be moved.
- Real estate is capital intensive.
- Real estate is illiquid and high cyclical.
- Each property is discrete and readily separable from other assets.
- Some jurisdictions have special tax and estate planning tools available.
- Shared ownership is typical, so partial ownership interests are common.

In addition, families and their enterprises have unique and distinctive characteristics, some common to families generally and others very specific to each family and each generation of that family.

- Time horizons tend to be longer than is typical for commercial entities, but may vary between generations.
- Internal capital can be made available, so loans and investments can be made without meeting standard commercial lending practices.
- Goals may be broader, less commercial, than typical goals for commercial entities and goals may not be transparent to all owners of the family enterprise(s)
- Decision making processes differ significantly from commercial companies and may be more influenced by family culture than by economics or law.
- Succession planning has different implications and applications.

Regardless of use or context, families and family enterprises with multiple real estate interests have a real estate portfolio. Optimizing the value of the family real estate portfolio means different things in different families. To promote optimal results (as defined by family owners), while simultaneously addressing issues of family control and family harmony, family members with interests in family real estate should discuss and formulate goals for various assets. This process might best be handled as an activity of the family governance process [see K. Midgely essay in this volume] or family office [see Gareth Ackerman essay in this volume]. The family enterprise should have a strategy for managing the portfolio which its leaders revisit from time to time as investors, shareholders and co-owners to be sure it is and remains consistent with family goals, optimizing returns as defined by the family. A family control group or board, like any other ownership team, should know and regularly review the value, debt, diversification, condition and management of the portfolio and its constituent assets and report on same to ownership.

To those ends

(1) The family, its enterprise and its outside advisors need a clear and comprehensive understanding of what is in the portfolio;

(2) The family, with guidance from non-family stakeholders and outside advisors, needs to establish general principles, short and long term goals for key decisions; and

(3) The goals should be managed and implemented by delegating decision making to people with expertise, experience and other qualifications relevant to obtaining the results desired by the family.

Defining and Understanding the Real Estate Assets and Portfolio

Any effective control of family controlled real estate starts with a list of all real estate assets owned or controlled by the family and its businesses. This list may include properties owned outright by a family business, properties owned by family controlled entities, interests held by a family business or family member(s) in properties owned by third parties, or interests held in property owned by a family member. The process of collecting basic information is not easy. It is unlikely to be in one place and family control person(s), for a variety of reasons, may have actively concealed information. Publically available documents may not provide necessary or complete information. The definition of family controlled real estate interests may be controversial within the family. However, the list, once compiled, will demonstrate its own importance.

Look at the following hypothetical example:

FAMILY PORTFOLIO

Asset Location	Title Ownership	Beneficial Owners of Record	Date Acq'd	Cost	Debt	Present Use
123 Main St. Anywhere	123 Main Realty Trust	Adam, Trustee of ABC Family Trust & David, Trustee of DEF Family Trust	1954	$89,000	0	Operation of family retail business
Grand Boulevard, Somewhere else	Grand Boulevard Ltd.	Adam's son + David's daughter, co- Managers	1992	€ 1.5 million	€1 million bank debt dated 1999*	Strip mall with branch of family business
2900 Industrial Park, Anywhere	2900 Realty Trust	2900 LLC, Adam, Manager	1961	$225,00 0	$200,000	Warehouse mostly used by family businesses
25 Rue St. Michel., #20 Paris	Tom and Christine		1998	€1.2m	€600,000 bank debt; $900,000 mortgage (ABC Family Trust)	Residence for Tom, Christine and their two children
The Poplars Spanish Town, BVI	The Poplars Ltd	Los Alamos Ltda	1952	$100,00 0	0	4 cottage vacation compound
1219 Lakeview Home town	1219 Lakeview Realty Trust	ABC Family Trust	1970	$225,00 0	0	6 unit apartment building
Condo in Miami FLA	QXR Ltda	Los Alamos Ltda	1986	$350,00 0	0 **	Primary residence of Joan, Adam and David's sister

* €1.5 million loan from Main Street Trust, interest paid currently, principal due on sale of property

** Purchased with cash

Definition of assets within the portfolio may be controversial. For example, the family members owning and living in the Paris apartment probably do not view it as part of the family controlled real estate portfolio. Consider including in the initial list of family owned or controlled real estate interests all properties in which a family controlled business—whether large or small— or one of its owners has an enforceable interest. A home bought with a gift from family members does not provide the donors or their heirs with any interest in the home. A recorded mortgage or, in some jurisdictions, an unforgiven loan, provides the mortgagee/lender with an interest in the underlying real estate, which may be part of their estate. Decision making for such an asset may be dealt with separately from other family interests once that property interest's situation and history are clearly understood.

Public records and documents in the possession of family members and their trusted advisors are the two starting points in creating this list. Generally, each real estate property is (or should be) held in a separate, "single purpose" entity so that liabilities relating to one property do not affect other properties and interests. Public records, then, may not be particularly informative about ownership (see, for example, the Main Street property, the Florida condo and the BVI property). Organizational documents and legal agreements among owners, such as LLC Operating Agreements, corporate Shareholder Agreements, Voting Agreements, help identify beneficial owners of real estate properties and interests.

The list, once compiled, may seem difficult to analyze. The issues raised by the chart above would fill a book. Analyze it one step at a time. Start by compiling information about each underlying real estate property:

- Its physical condition, maintenance requirement, necessary or desirable repairs, necessary and desirable capital improvements
- Its financial condition, debt, reserves
- Income and Expense data
- Management reports, insurance policies
- Appraisal of the property's fair market value (highest and best use)
- Fair market value of the family owned or controlled interest in the property
- Other issues (tax, cost basis, family history of ownership)

Financial statements for the entities owning commercial properties and the properties' rent rolls should provide a current and historical financial picture for each property: revenues generated, operating expenses, major expenses, debt (secured and unsecured), capital reserves and net income paid to owners. For other types of properties, relevant financial information should (but may not) appear in individual financial statements. In some jurisdictions, this type of information can be obtained from tax returns (at the entity level and the individual level). Family accountants, financial advisors and tax advisors should have this information.

The physical condition assessments for major family enterprise assets, such as the Main Street store, the warehouse, the strip mall and the BVI property shown in the example above, should be supported by reports from independent experts. Family and related party assessments may be affected by emotions and relationships and, consequently, cannot carry the same weight as third party analyses. Certainly the family should know whether there are significant issues of deferred maintenance and improvements. These issues will impact the value and long term cash flow of the property. Management should have a reserve fund, a schedule and a budget for maintenance, repairs and capital improvements, all of which it reviews with ownership at least annually.

Evaluation of existing property management staff should likewise be performed by independent real estate professionals, particularly where one or more family members are or would like to be involved in managing assets in the real estate portfolio. Credentials, fees, leases, leasing policies and practices, insurance coverage and costs, maintenance standards and practices, financial records and performance are all examples of criteria which should be examined in the light of industry benchmarks. Industry benchmarks are needed as a starting point for analysis but are not definitive. Each property is unique, with specific characteristics, such as location, condition, occupants, and history. Performance and fees, for example, may be affected by family goals and decisions. Moreover, the choice and use of benchmarks are likely to cause controversy and disruption when family members are involved in property management, so independent advisors can be especially useful for all parties in this analysis.

A professional appraisal is needed to determine the fair market value of each piece of real estate. The appraisal should include analyses of the property itself, the market in which the real estate is located, recent sales of comparable properties in the area, the potential uses of the property and the highest and best use for the property. Appraisals generally include an estimate of replacement cost of the buildings and other improvements on the property (which is useful in determining whether the property is appropriately insured against casualty loss) and a general assessment of its condition. Real estate appraisals should provide comparable sales data. This is a common basis for an estimate of “fair market value”–that is, the price that a willing third party buyer would pay for 100% ownership of the property.

Appraisal of a commercial property should include a valuation based on net operating income from the property’s highest and best use, which may well be different from its present use. Owners of the property (and the owners of the business) need to understand that information in order to determine the long term relationship between the business and the property. Similarly, an independent appraiser should evaluate fair market rents for each commercial property, particularly if family members or family owned or controlled businesses occupy all or part of the property. Below market rents reduce the cash available to make improvements, to make distribution to owners or to buy out family members. They also reduce the fair market value of the property itself to the extent that the below market rents are locked in by enforceable lease agreements. If the family business rent level is not documented in a written lease agreement with the entity owning the real estate property, then there also are non-real estate business risks for the family enterprise. Before the family decides, as a basic principle, to continue renting to family members or their businesses, and whether to discount rents for family members or their businesses, they need to know the short and long term costs of that decision.

If a family member or enterprise owns less than 100% of a real estate asset (as is often the case with family real estate businesses) the fair market value of that interest must be analyzed separately from the fair market value of the property itself. Typically, lack of liquidity (inability to convey the property free and clear of other interests) and lack of control (minority interests) *each* reduce the value of a partial interest by as much as 30-35%. Assuming the Main Street property in the hypothetical above has a fair market value of $5 million, the DEF Family Trust's 40% interest may have a fair market value of $800,000 or less, unless there is an agreement binding on both the DEF Family Trust and the ABC Family Trust that dictates otherwise.

The control and liquidity discounts on fair market value provide both issues and opportunities to families. Family members not involved in the family business or property management often want the ability to separate their finances from the family enterprise by selling their real estate interest back to the family at a price based on their percentage interest without discounts. However, before deciding that individual family members should be able to sell their interest(s) in a family real estate asset without reference to discounts for illiquidity or minority status, the family should consider their comfort level with transfers to third parties and (alternatively) the ability of the real estate entity or other family members to pay (or finance) the undiscounted price without impacting the business' needs. On the other hand, the heavily discounted fair market value of illiquid and minority interests permits family members to make intra-family transfers (whether by gift, inheritance, trust or sale) at low values which minimize taxes and facilitate family buyouts. The interest of some family members in reducing tax consequences of intra-familial transfer may conflict with the interest of others in the ability to transfer their minority interest for their "fair share" of the family asset. Family governance systems should address the need to balance conflicting interests.

The information for each property should be organized at a portfolio level, separating different types of real estate assets: commercial (retail), commercial (residential), industrial, commercial paper (retail property), commercial paper (personal residential), personal use for family members. Diversification will be a topic of discussion if maintaining a portfolio of real estate assets over the long term is a goal of the family enterprise.

Tax issues should be identified. In the example above, transfer of the Main Street property or any interest in that property (especially the majority interest) will create large tax liabilities. The Main Street property owner holds a mortgage on the Grand Boulevard property, securing a loan which cannot be repaid out of sale of the property. This presents an opportunity for tax planning and the challenge of addressing the interests of family members who have an interest in the Main Street property but not in the Grand Boulevard property. This highlights the need to identify individuals holding interests in each property in the family real estate portfolio and have a governance system for balancing conflicting interests.

Interest and Stakeholder Analysis

It is crucial to identify family businesses, trusts, other family entities and individual family members with an interest in each asset contained in the family real estate portfolio. These interests, including rights and obligations, are generally found in the agreements underlying the various entities in which assets are held (partnership agreements, member agreements, operating agreements, voting agreements, etc). Lawyers and accountants often have documents or information about these interests (arising, for example, from intra-family agreements or transactions). Interest holders clearly have a stake in key decisions concerning the property in which they hold an interest. Failure to include them, in some manner, in key decision making is an invitation to conflict.

It is also critical, however, for any family owned or controlled business or concern, to identify the non-owner stakeholders and their interest(s) in the business, including its real estate assets. Stakeholders may include blood relatives of family business or family real estate owners, in-laws, key employees, neighbors, customers, non-profit organizations – any person or entity affected by policies and decisions concerning the business or real estate asset. Their interests may be constant or occasional, apparent or counter-intuitive, real or perceived. Nonetheless, to establish meaningful policies and make effective decisions, identification and involvement of stakeholders is critical. Even when key stakeholders disagree with a policy or decision, they are more likely to accept it if their interest has been validated and they have been involved in the process.

Identifying interest holders and other stakeholders can be difficult. Conversations with family decisions makers and their trusted advisors, extended family and non-family executives are good starting points, but only starting points. In many families deeply held custom and/or a culture of secrecy may preclude any easy discovery of true holders of economic interests beneath the cloak of a trust, an LLC, a Limitada or other entity. Other families keep such information secret based on emotional motivations (sometimes acknowledged but often undiscussed and unknown) such as grudges, sense of obligation, family relationships, family history and the like.

Therefore, discussions with family historians (people knowledgeable about the story behind each property or interest) can be very helpful. Family historians are generally, but not always, older family members or advisors. They have information about family member (and stakeholder) actions and inaction(s), spoken and unspoken understandings, conflicts, myths and misunderstandings. This information is not only relevant but can also be critical to establishing principles and goals for the family enterprise real estate. History can create destructive family mythology, particularly if not understood, acknowledged and addressed. Consider the detective work required in the portfolio below, which has been constructed to illustrate the points in the foregoing paragraph, but which is derrived from several different real life scenarios.

FAMILY REAL ESTATE PORTFOLIO

Asset Asset Class	Control Person(s)	Ownership Structure	Pre-Tax Value	Family Interests	Rent Revenue	Family Income
Retail						
Main Street Urgently needs $125,000 in repairs Needs capital improvements of $1million	Adam	ownership split 60/40 between Adam's family and David's family	$5 million	Adam, David, Adam's family David's family Family business is sole tenant	$600k	$50k to Adam, 0 to owner-ship entity Employs 12 family members
Grand Boulevard Fully Renovated	Adam' son	Ownership split equally between Adam's 3 children, David's 3 children,	€2 million	6 cousins 1 in-law executive Main Street, 2d Mortgagee* Family business is 1 of 8 tenants	€575k	€36k to Main Street (interest) €25k to In-law mall manager
Industrial						
2900 Industrial Park Building in disrepair, no capital reserves	Adam	Adam's ex-wife	$1.5 million	Adam, all family members with interests in family businesses	$300k	$200k annual distribution to Adam's ex-wife
Commercial Residential						
1219 Lakeview Reasonable maintenance and repair funds available	Adam dtr	Adam, Adam's 3 children in equal shares	$3 million	Adam, his children David's mgt. company 2 of David's grandchildren lease units there	$380k	$120k $25,000 fees to manager Below market rents (2)

Miami Condo Good condition	Martin	Martin, Veronica (Joan's children)	$500k	Martin, Veronica Joan	0	($60k) annual maintenance
Other						
Paris Mortgage	Adam	Adam's 3 Children	$900k + interest	Adam's 3 children Tom, Christine, their children	0	Tom, wife, get use of money and home
Family						
The Poplars	BVI lawyer	Grandma & Grandpa's descendants	NA	Presently 23 individuals	0	0 – families members vacation there

* Value of underlying asset will not pay second mortgage principal in full

The compilation of varying analyses made of each real estate interest and the family real estate portfolio generally highlights areas of family concern as well as areas where strategic planning and management issues need to be addressed. For example:

- The ownership structure of the Main Street property is an invitation to dispute between members of Adam's family and David's family at some point. The loan to Grand Boulevard adds to the likelihood of conflict. An agreement among Adam, David and all their children on basic principles and key decision making is advisable.

- At the same time, Adam, David and their families may want to discuss the apartment building owned by Adam and his children, managed by David's company, partially occupied at discounted rents by two of David's grandchildren. There is a story about this property, its family history (Grandma lived there, Adam bought it, David's company is paid to manages it). There may be understandings, expectations and/or misunderstandings about this property.

- Ownership of the family warehouse by a former spouse presents problems for the family businesses. The property is being drained of cash to the detriment of the property and its renters. A lease should define the landlord's obligations and be enforced.

- Use, care and support of The Poplars can become increasingly problematic as the family continues to expand and extend. Ownership becomes increasingly diluted and governance becomes increasingly difficult. Conflicts may arise over use and/or care of the property. The property will always require funds and management for its operation, maintenance, repair and improvement. The assets of Los Alamos Ltda may not always be adequate to cover these expenses. Hopefully Grandpa and Grandma dealt with these issues and discussed solutions with their children at some point in the first thirty years after property acquisition, but if not, or if the structure and finances are not or will not continue to function well, these issues should be addressed presently.

- There is a story about the Florida condo which should be understood and discussed among the family and their advisors. What was the source of the purchase money and what is the source of payments for its operating costs? Who are the real interest holders and stakeholders? What is the agreement with Joan and why? Real estate interests with insufficient documents or unusual terms raise red flags that should be pursued discretely to identify significant tax, other legal issues and family issues.

Decision Making Systems for Managing the Family Controlled Real Estate Interests

Fundamental principles and goals for decisions concerning family owned and controlled real estate interests are different from those of standard commercial real estate owners, which tend to focus primarily on financial goals with time horizons of five years or less. Fundamental principles and goals for family real estate are similar to those the family owners establish for other family assets, in that they include financial factors, long term and near term planning requirements, issues related to core family values [both explicit and implicit] and, optimally, relationship to the overall family wealth plan. They inform strategies and decisions, such as:

- Asset management priorities and principles: short, medium and long term income/value/ growth allocations, risk tolerances
- Priorities for income generated (support of older generation, meeting income expectations of current generation, investing in property and its value)
- Ability to transfer interests (to spouses, future generations, family members, third parties) and tax minimization in relation to same;
- Role of family members in management of individual real estate assets and the portfolio;
- Whether (1) to maintain family ownership and control of all or some of the assets/enterprise, (2) to distribute some or all of the assets among family members (3) to sell or liquidate assets in an orderly manner.

Basic strategies are best set, decisions best made, properties are best managed and family conflict is most likely avoided if the family can achieve consensus and agreement on: (1) guiding principles for family decision making, (2) ultimate goals for the portfolio and its constituent parts, (3) a short list of key decisions over which family interest holders have input and control, (4) a governance system using input from independent professionals and advisors to oversee the real estate portfolio and (5) employed professionals (which category can include qualified family members) to manage the real estate assets. It is critical to good decisions and avoidance of conflict that all family interest holders be involved in discussion and resolution of items 1, 2 and 3 and establishment of the system described in item 4. It is prudent to have stakeholder input as well, and to use trusted advisors and qualified professionals in the process of working toward consensus and agreement.

These decisions can and should be integrated into decisions for the family enterprise as a whole. Some of the unique characteristics of real estate can facilitate (or impede) family goals. For example, a single property can be sold to finance investment in the family business. Piecemeal distribution of properties to individuals can separate joint holdings and preserve family relationships. Tax considerations will drive the timing and method of such sales and distributions.

First generation family real estate owners often believe they have the right to (and do) make decisions without consulting other family members. It is probable that the founders have minority interest holders (tax, inheritance, liability and inheritance considerations encourage the separation of interests legally, economically, financially and physically) but they usually retain some degree of control. However, founder decisions often do not survive their own deaths without the input of minority and successor interest holders. The second and third generations of a real estate family I know are engaged in endless and expensive litigation over various interests in real estate entities, replaying undiscussed (and now unknown) family stories and emotions.

First generation real estate owners, however, generally do have the familial authority to lead family decision making and encourage family culture, based on their own beliefs and principles. This leadership improves the likelihood of success should the family engage in a process of discussion, consensus building and agreement on principles, goals and key decisions. However, founders (and successor family members in control of decision making) may or may not have an accurate read of the family culture and the principles and goals of individual family members. They also may be receiving incomplete and/or distorted information, or may be unwilling or unable to process information that is inconsistent with their plan or family image. Many families are not comfortable discussing these issues openly with the entire family and it is common to find that some family members' expressed views change from one family setting to another.

Confidential questionnaires can help open a meaningful discussion by getting individuals' input on fundamental principles and ultimate goals. Answering questions privately allows the individual to think through some of the questions and respond without fear of "social consequences". A reading of the responses as a group gives the questionnaire manager a good idea of emotional and personal issues. Collating the responses without attribution facilitates open discussion. Consider the following:

1. *I would like to know what is important to you. Please give each of the following general goals a number between 1 and 10, with 1 indicating highest importance and 10 indicating no importance at all.*

GOAL	Importance	Comments (if any)
Providing for my spouse and children		
Providing for the older generation		
Providing for my siblings		
Continuing family ownership of the business		
Having family work in the family enterprise		
Getting income from the family business		
Taking care of family business employees		
Continuing ownership of real estate		
Work/Life balance		
Being successful		
Sharing equally in the family wealth		
Being treated fairly by the family		
Creating wealth for future generations		
Avoiding taxes generally		
Avoiding taxes personally		
Giving back to society		
Charitable giving		
Making sure my children are self sufficient		
Maintaining extended family relationships		

2. *Please read the statements below and check each statement with which you agree*.

The Poplars: I want to keep The Poplars in the family. ___
I want extended family to continue to use The Poplars. ___
I want to retain family ownership of The Poplars even if that means selling other family assets. ___
I want to retain family ownership of The Poplars even if that means my income from other family assets goes down ___

Main Street: I want to keep Main Street owned by family members only ___
I want to keep Main Street owned by family members only so long as the business remains there. ___
I think each family member should be able to cash out his/her interest in Main Street. ___
I think the family should buy out a member who wants to cash out at undiscounted fair market value. ___
I would be willing to buy a member's share myself at a fair market value price reflecting discounts. ___
I would be willing to buy a member's share myself at an undiscounted fair market value price. ___
I would be willing to sign off on a loan to enable Main Street Trust to buy an interest at a discounted value price. ___
I would be willing to sign off on a loan to enable Main Street

Trust to buy an interest at an undiscounted value price. ___

I am willing to employ a family member to work in family real estate management, if:

(S)he is qualified for the job. ___
Our independent board says (s)he is qualified for the job. ___
(S)he needs a summer job. ___
On an interim basis until (s)he finds work. ___
If other family members are employed at a family business or real estate property. ___
If it doesn't reduce my income. ___

Each family has its own culture. Some enjoy extended family but have branches which cannot work with each other. Some are open to discussion of and dispute over issues, but cannot reach agreement on major issues. Some have a culture which inhibits (or prohibits) meaningful discussion of issues or disagreements. Some have a culture which cannot tolerate open or collaborative decision making.

There are many other reasons why families may be unable to reach agreement on fundamental principles and goals. Inability to obtain consensus or set meaningful family goals is not a failure of family members or stakeholders, but should be acknowledged and incorporated into the process for making key decisions. Many families who fail to build consensus on decisions are comfortable having some decisions made by a supermajority of family interest holders. The reality that the family does not agree on some fundamental principle(s) or goal(s) might encourage separation and distribution of assets in the short run (which maintains continuity of family ownership, albeit not for all family members) and sale of other family holdings in the longer run. A process which arrives at such a strategy, acknowledging realities and creating agreements to implement a strategy accordingly, constitutes a significant success.

Interestingly, though, discussion of issues such as disposition of real estate may trigger emotional discussions that yield light as well as heat, leading families to consider long term issues and providing opportunities for families to craft appropriate outcomes. However, the process of productively discussing emotionally powerful issues requires time, effort and certainly more than one meeting. If the family interest holders are not willing to commit to this effort, then consensus will not be possible.

Similarly, there are many reasons why families which agree on fundamental principles and goals ultimately sell assets and/or businesses. Here, too, a process which includes input from all family interest holders will achieve results, financial and other, that are conducive to good family relationships. And as with family controlled operating companies, sale or other disposition of a legacy real estate asset may constitute a great success both relationally and economically. [See generally the J. Halyck essay in this volume.]

If consensus can be achieved, written agreements will—and are necessary to-- perpetuate the decisions reached. A Family Agreement can include a list of key decisions (buy/sell, sale price and structure, refinancing, ground leases, change in portfolio strategy, change in management companies, for example). This Agreement should also include methods for making decisions (e.g. who votes on what, what votes require a simple majority of interest, what votes require a majority of interest and a majority of family interest holders, what votes requires supermajority). If continuity is a goal, it should include methods of selecting successor owners and control people, as well as methods for family members to exit the ownership group. There should be provisions relating to dispute resolution (and litigation deterrents, possibly). There should be agreement on how jointly held real estate assets will be managed and operated, how their boards and managers will be selected and what powers their boards and managers should have.

Operational agreements (or appropriate amendments to existing agreements) should implement the governance decisions in the Family Agreement, establishing boards, management structures, reporting requirements and oversight appropriate to each real estate interest and the portfolio. Independent advisors are particularly important to strategic and operational decision making and should be included on boards and/or in property management for many reasons. They can facilitate communication between management and ownership on issues such as operations, initiatives, transparency, accountability and transfer of ownership or control. They do not have the emotional investment in family history or the emotional attachment to particular real estate properties. They do not have financial interests or operations roles in the real estate or the family business. They provide desirable areas of expertise, with the credibility of impartiality. Opening decision making to outsider input, however uncomfortable this idea may be initially for family owners, improves performance of the real estate portfolio and has profound benefits for family owners.

Conclusion

Real estate is forever. When properly managed, it provides long and short term financial and emotional benefits. It can provide tax, ownership and transfer flexibility to the family's overall aggregation of wealth and assets. It can provide a place for family fun, culture and bonding. It can provide a means for separating and distributing family assets to maintain long term family relationships and/or a means for maintaining continuous ownership to preserve family legacy.

Good decisions, based on financial and family goals, optimize these benefits – but only if they are and remain effective. Effective decision making requires - at a minimum - receiving and considering input from all interest holders, relevant stakeholders and trusted advisors with necessary expertise in areas such as finance, law and management of real estate (as well as an understanding of the family and its issues). Hopefully, with assistance from independent advisors, the family will arrive at a written agreement on principles, goals and a system of governance for making short and long term decisions on the management of their real estate portfolio.

