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Challenges and Opportunities of a Family-Owned Real Estate Company

By Sheryl C. Starr

In November 2014, a panel at the Urban Land Institute Fall Meeting revealed that, due to poor succession planning, family-owned real estate companies are dying out. That doesn't have to happen.

In many respects, the challenges facing family-owned real estate companies are the same as those found in any family-owned business:

- How to determine which family members will be involved and what will be their roles.
- How to transition authority and ownership from one generation to the next.
- How to resolve conflicts in operations, management, goals and values.
- How to structure estate plans to minimize taxes and maximize asset transfers to future generations.

Luckily, family real estate businesses have opportunities to structure ownership and management, as well as tax and estate planning, in a more flexible way than other family businesses.

Let's look at two typical clients.

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Pat and Mary built their business from scratch, and now own more than a dozen office buildings. Pat's daughter, Sue, got her MBA and was excited to join the company. His son, Tom, loved teaching, but felt obligated to work in the business as Pat wanted. The family worked together, but relations were

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strained because Sue felt that Pat undermined all of her decisions, and Tom wasn't really interested. Pat and Mary always intended to address estate planning needs, but neither wanted to give up control, and Pat was worried that if he "gave away" too much, the banks would not look favorably on his financial statement. When Pat died suddenly, Sue struggled to make decisions on her own, the banks started to call in loan guarantees, and Sue felt that Tom wasn't pulling his weight.

David and Sarah also spent many years building up their real estate holdings. Their daughter, Jennifer, is now in charge of retail development, and their son, Nate, handles office development. Their middle son, Jason, is a writer who occasionally contributes to marketing efforts, but spends most of his time in California. David is planning to retire soon; Jennifer is poised to take over as chairman, and she and Nate have good relations with non-family member employees. Jason is happy because he gets to do what he really loves, but still has some income from the family business.

So how did David and Sarah get it right?

Communication. David's family did not always have smooth communication, but they started early and now meet regularly, sometimes with the help of a family business consultant, to resolve differences in management styles and acquisition opportunities. When Jennifer saw a hot market in an up-and-coming, but underdeveloped, area of town, the family agreed to acquire retail space that would support the hip new restaurants Jennifer loves. Nate is concerned about the environment, and takes great pride in the sustainable and energy efficient office buildings in the family portfolio.

Tax and estate planning. David spent considerable time working with both his real estate attorney and his estate planning attorney, using vehicles such as limited liability companies, generation skipping trusts, intentionally defective grantor trusts and installment sales, to structure an estate plan that gives him the comfort that his estate will not be consumed by taxes, and that assets will stay in the family for future generations.

Ownership interests. Although not all of his children are equally involved, David wanted to be sure that each of his children (and his grandchildren) had an ownership interest. Using a separate LLC for each building allowed ownership interests to be tailored to meet his estate planning goals and still be fair to each of the children.

Financing considerations. David's attorneys were able to properly structure sales of ownership interests to family members, so that David's financial statement was not adversely affected by those transfers. His attorney also made sure to negotiate loan documents so that the banks would not call the loans upon his death.

Like other family businesses, family real estate companies need to start succession and estate planning early, help children and other family members find their niche, create financial structures that work for all family members and, most of all, maintain communication among the members.

The very nature of real estate lends itself to flexibility in each of these areas. However, it is not easy, and too many families are unwilling to put in the effort needed to achieve success. The first step to creating and maintaining a thriving family real estate business with a solid succession plan is to bring in third party professionals, such as a real estate lawyer who understands the industry, experienced estate planning lawyers and other financial and business consultants. ■

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