TAKE REAL ESTATE GIFTS!!!!

Chase V. Magnuson
President
Real Estate for Charities
4031 Thunder Creek Lane
Sugar Land, Texas 77479
Chasemagnuson@msn.com
(714)815-8889

Introduction and Objectives

In today's session I will explore the reasons behind the increased attention in recent years to the potential of real estate gifts, and we will review the current state of the art in real estate giving. I will review the range of real estate gift structures, and the situations for which they are appropriate. Based on the experience of charities that have been quite successful in attracting high quality real estate gifts, we will review the emerging best practices in the field of real estate gifts – practices aimed at increasing the quantity and quality of real estate gifts. I will illustrate the use of various gift structures, and the application of best practices, in a review of five case studies – real estate gifts I have personally worked on in recent months and years. Finally, I will review alternative approaches to structuring real estate gifts – alternatives used primarily to better manage some of the risk inherent in real estate gifts.

I want attendees to leave with a better understanding of the potential and practice of real estate gifts. Specifically, I hope that planned giving and other development professionals will leave well-armed with facts and arguments they can use in persuading management within their own institutions to more purposefully pursue the potential of real estate gifts. At the core of the argument is this essential fact: Real estate is by far the largest asset class for American households – larger than retirement funds, larger than investments in securities of all types, much larger than holdings of cash and cash-equivalents. With over 40% of US family wealth in real estate, yet only about 3% of charitable giving coming from real estate gifts, it is our contention that a focus on real estate gifts in the future will be essential to the charitable sector's continuing success in attracting capital.

I hope many attendees will be convinced that attracting and closing the right real estate gifts is not rocket science and is not a discipline to be left only to the largest of institutions. I want attendees to understand there are a variety of ways their own institutions can take modest steps toward harvesting the enormous real estate wealth transfer that surrounds them every day. I want attendees to leave with a balanced approach to real estate gifts – yes, such gifts can be complicated and require investment of resources and expertise, but there are ways to concentrate time and resources on the truly promising gifts, while quickly screening out the problematic situations in a donor-friendly way.

I hope to convey the message that real estate gifts should not necessarily be considered as complicated gifts that won't provide useable financial resources for many years. In fact, I will show that a very high percentage of today's real estate gifts are outright gifts – i.e. gifts that can be turned in to cash in a matter of months, often – with relatively few complexities along the way. As such, we believe that real estate gifts should not just be relegated to the world of gift planning, but should be an essential strategy of major gifts, principal gifts, capital campaigns – in other words, a pursuit of the opportunity represented by real estate wealth transfer should be woven into all aspects of an institution's development strategy and procedures.

I want attendees to understand that the reluctance of many institutions over the years to pursue real estate gifts has more to do with the conventional "handbook" of fundraising -- and to stories about the "bad real estate gift" twenty years ago -- than it does to the reality of the real estate gift potential and the sophistication of today's profession in harvesting that potential while carefully managing risks.

Review of Trends in Real Estate Gifts

It has been my experience at George Washington University and as a consultant working with many non-profits across the country – that more organizations have experienced an increase in real estate gift activity in recent years than have experienced a decrease in such activity. Anecdotal information and showings of hands at conferences support this contention, though hard data is hard to come by.

I ascribe several explanations to this recent trend. First, I believe that many development shops, faced with steady (or increased) pressure to produce results, and confronted by the continuing reality that gifts of cash remain hard to come by as donors seek to retain liquidity, and recognizing that it will be some time before gifts of appreciated securities pick up, are turning their attention to other asset classes, with real estate being at the top of that list.

I find that this awareness has translated into an increase in the marketing of real estate gifts on websites and in newsletters, and we find more and more gift officer job descriptions and searches include an emphasis on real estate gift experience.

Second, I find that more and more aging owners of multiple properties find themselves, as they seek to simplify their lives, looking to dispose of one or more of their real estate holdings – often a little-used vacation home, or an investment property requiring more attention than they want to give it. Such property owners are often very receptive to charitable disposition solutions that provide them with an ability to turn over to others the chore of marketing their real estate in what they perceive as volatile real estate markets.

Third, it is my experience that more gift planning directors are able to convince their bosses to pursue real estate gifts because of the fact that their peer institutions are more and more likely to have had success with real estate gifts, and because of the availability of expertise and access to best practices through conferences, professional journals and consultants.

An Overview of U.S. Real Estate Wealth Today

Even with softness and volatility in United States real estate markets in recent years, real estate remains by far and away the single largest category of assets for U.S. households. Real estate comprises 43% of household wealth in the United States – some $67 trillion. This is a sum roughly equal to all stock and bond holdings combined. Though by far the greatest attention in the fundraising world is devoted to pursuing gifts of cash and cash equivalents, these assets account for only 15% of household wealth, or about $9 trillion.

In other words, roughly 90% of the attention of the fundraising world is devoted to that 14% of household assets in cash and relatively liquid instruments. Meanwhile, scant attention is traditionally paid to those assets that account for 43% of household wealth – real estate holdings.

A growing realization that "real estate is where the wealth is" is no doubt responsible for much of the increased attention among development professionals to pursuit of real estate gifts.

Thanks to studies conducted by the National Association of Realtors, we have a good idea how much of this real estate wealth is in residential properties other than primary residences. One in ten households owned 2 or more residential properties. One in 25 owned 3 or more properties.

In other words, many, many of our donors – people who do not live conspicuously wealthy lifestyles – quietly own summer homes, investment properties, inherited farms etc., in addition to their primary residences. Our own personal experience bears this out. I often encounter families leading relatively modest lifestyles who, as it turns out, have owned an inherited vacation home or ski condominium for many years, or they share ownership of an inherited farm with one or more siblings, or they still own the triple-decker residential property they invested in twenty years ago.

Furthermore, I know that it is these supplemental residential properties that change hands with great frequency. We know that fully 40% of residential sales in any given year tend to be these second, third and fourth homes. In other words, if you are working with a prospect who owns a second and a third home (not that unusual, as it turns out), there is a good chance that in the next few years they will be thinking about what to do with one of those properties.

The late John Brown had access to more refined data that captures this phenomenon. He was fond of saying:

> "Among property owners age 50 and over, 18% of them will sell a piece of real estate in the next 18 months."

What does this mean for the fundraising world? It means we need to find out who these owners of multiple pieces of residential real estate are, especially the older ones, and we need to be sure they know that there are tax-advantageous alternatives to simply selling those properties.

We need to be sure they know that when the time comes for them to start thinking about disposing of one of their properties, they will know to give us a call to explore possibilities, rather than just automatically list the property with their local broker.

What Real Estate Donors Look Like, and What Motivates Them

I know that many donors of real estate are individuals and families who own multiple pieces of residential property. But what do we know about their motivation when they do make a gift?

There have been studies produced nearly identical results: There were three factors at the top of the list of what motivated property owners to donate real estate. They are: resonance with the mission and good work of the organization (i.e. charitable intent); desire to use the tax benefits from the gift (avoidance/minimization of capital gains taxes as well as charitable deductions); and a desire to be relieved from the headaches of continued ownership and management of the property. Significantly, the third of these – getting out from under the burdens of property ownership – was rated equally with the other two.

This tells us a great deal about how to market our institution's interest in attracting real estate gifts. In our marketing and outreach we should be reminding our prospects that we understand that many of them will find themselves in a position where they might start to feel that continuing ownership of their property is more burdensome than beneficial, and that we have creative ideas that could very well solve their problem while enabling a very generous gift.

From experience we also know that there can be particular fact patterns that will lead aging property owners to be especially receptive to conversations about the disposition of their real estate. For example, many people today are wary of the emotionally-taxing process of working with a broker to list and sell their home. To be told that the vacation home that was worth $2 million several years ago should now be listed for a *mere* $1.4 million, with hopes of selling it (after reductions in listing price) at maybe $1.2 million, can be very difficult for a family to take. Given the alternative to deed it over, take a deduction for the full appraised price, avoid any exposure to capital gains tax, *and let the college (for example) worry about the marketing process*, can be very attractive.

Other motivating factors include:

- wanting to convert a non-performing (from a financial point of view) asset into assets that might generate 5% or greater (through a charitable remainder trust, or through a charitable gift annuity), to supplement retirement income;
- wanting to trigger a big deduction to help offset the large gain coming from sale of a family business or another property;
- wanting to make the decision about the property now, once and for all, rather than arguing about it with family members for the next 20 years.

To summarize the profile of a likely real estate donor:

- Age 65+
- Owns multiple pieces of real estate, likely in multiple states – much of it is appreciated.
- No heirs, or children moved away and not interested in the real estate.
- If there are children, there are other assets to pass on to them.
- Want to preserve their liquidity.
- Capacity to use charitable income tax deductions.
- Charitable motivation.
- May or may not have a strong giving record.
- May or may not show up on wealth screening.

What Today's Real Estate Gifts Look Like

From surveys I know that 50% of properties donated tend to be residential properties – roughly 30% second/vacation/rental properties, and 20% primary residences. Other properties donated, in order of declining frequency, are undeveloped land, commercial properties, farms and ranches, land with conservation value, time shares, and industrial properties.

It is my belief that with the possible exception of time shares (and cemetery plots!), virtually no particular type of real estate should be automatically dismissed. Rather, we believe that with rigorous screening and due diligence procedures in place, it is possible to sort out the promising gift properties from the troublesome ones, regardless of whether the property in question a summer home or a factory is.

Thanks to periodic reports from the IRS, "Individual Non-Cash Charitable Contributions," we have some good data on real estate gifts as reported on Forms 8283 attached to tax returns. The latest study – of 2016 returns – tells us that slightly over $640 million in real estate donations were reported in 2016. (This includes conservation easements and façade easements). In that year the average (mean) real estate donation was reported as $268,000. This number has declined in recent years, but it is still a substantial number for the *average* real estate gift.

When gift officers and development vice presidents point out to us that the pursuit and closing of real estate gifts involves front-end expense, varying degrees of complication, and that some gifts don't make it across the finish line, our response is: Yes, that is all true. But, if you screen your gift possibilities carefully at the outset, and spend your time on just the promising gifts, and if those gifts average over $250,000, isn't it worth a little effort and expense to bring in such gifts?

I am are asked if it's true that many properties offered as real estate gifts are encumbered with mortgages. My experience, and the data, suggest not. According to the Statistical Abstract of the U.S., for persons age 65 and older, fully 83% of their real estate holdings are debt-free. And since most real estate gift conversations involve owners 65 and older, there is a very good chance that a mortgage won't be a factor. And, if a mortgage is involved, more often than not work-arounds to the mortgage can usually be figured out.

Emerging Best Practices

There can be no question that the development world, and the networks of private advisors, and the number of institutional partners and private consultants involved with real estate gifts, have collectively learned a great deal in recent years about good, and bad, ways to go about attracting, structuring, screening, investigating, closing and disposing of real estate gifts.

I believe that it is appropriate to claim that best practices in the field have in fact developed and are constantly being refined.

The following summary of "Emerging Best Practices" is based on a study as well as my experience and that of our clients in attracting real estate gifts.

Policies and Procedures

I have found that for almost every institution it makes sense, before ramping up the marketing of real estate gifts, to review and amend gift acceptance policies and procedures to be sure they properly address what that institution does and does not want to pursue and accept as real estate gifts. The state of the art has advanced greatly in recent years, and it makes sense for gift acceptance policies to reflect this collective learning. Also, the process of conducting such a review can become an opportunity to educate key staff and board about the magnitude of the real estate gift opportunity, and can provide the mechanism for achieving buy-in of key players, including the CFO or the General Counsel, or wherever it is that institutional caution about real estate gifts has traditionally been housed.

Such a review can often achieve a considerably stream-lined approach to reviewing and deciding about real estate gifts. Many institutions discover that they have unnecessarily burdened the real estate gift review process by having too many hands in the pie. Often, the process can be simplified with absolutely no sacrifice of the quality of the review.

Revising procedures for handling real estate gifts can also provide an opportunity to become more "donor-friendly" throughout the process. Often, an institution's caution about real estate gifts is reflected in rather off-putting procedures, e.g.: a potential donor inquiring about possibly making a real estate gift is asked to complete a 10-page questionnaire and supply many pages of documents. If an institution is truly interested in accepting real estate gifts, then its approach to dealing with prospective donors needs to be friendly and oriented to problem-solving.

More and more organizations are adopting a gift minimum concerning real estate gifts. Increasingly, the yardstick being used is not simply the estimated value of the real estate asset in question but is, instead, the estimated likely net value to the organization, in today's dollars, of the gift when all is said and done. For example, a vacation home may appraise at $200,000, but if it is proposed as the funding asset for a 6% Charitable Remainder Unitrust for 63 year old beneficiaries, then the true likely value of the gift – taking into account various expenses along

the way, making actuarial assumptions, and bringing everything back to present dollars – might be more like $75,000. It certainly isn't $200,000. We have found that it is good rigor for an institution to do this preliminary analysis early on, in part to temper expectations, and in part to help decide whether to pursue the gift.

And finally, we know that the most successful real estate gift programs offer a very full menu of structuring options to their donors, so that they can use the whole toolbox in crafting a solution to fit the donor's particular circumstances. Therefore, a review of gift acceptance policies and procedures becomes an opportunity to carefully broaden the menu of offerings, while thinking through particular policies for each structure. In other words, the most successful programs include charitable gift annuities and bargain sales and fractional interest gifts on their menu, as well as bequests, outright gifts and charitable remainder trusts.

Marketing

I am occasionally challenged about our enthusiasm for the potential of real estate gifts with questions like: "I'm skeptical about the whole real estate gift thing. We 've received only three calls in the last two years." To which we often respond: "Have you given your alums/members/donors any reason to think that you are interested in receiving real estate gifts? Do you mention it on your website? Do you include it in your mailings? Do you highlight it at reunions?" Most often the answer to these questions is: "Well, no, not really." To which we respond: "They are not going to give you a call unless you give them some reason to call."

I have found that some messages work better than others when getting the word out about an organization's interest in real estate gifts. As a general rule: "Give us your real estate. We're a great organization and we'll do great things with the money" doesn't work terribly well. On the other hand: "Perhaps you find yourself thinking about a piece of property you might need to dispose of in the years ahead. If so, give us a call. I have some ideas you might find interesting" can elicit responses. In other words, it helps to put yourself out there as someone who understands their situation/problem and is in position to help them solve their problem.

Like other marketing situations, the message needs repeating often, in different media – newsletter, website (where, in our opinion, real estate deserves its own page rather than being buried on Planned Giving pages), enewsletters, social media, etc.

Not surprisingly, case studies (real examples work best, but hypotheticals are better than not doing it at all) are most effective.

No matter what the message and the medium, it's critical that the organization's response be timely, friendly and professional. As I suggested before, there's no point in launching a sophisticated marketing program if the response is to fire off a request to complete a lengthy questionnaire and send copies of legal documents.

Initiating the Conversation with Prospects

As important as it is to market an organization's interest in real estate gifts, we have come to believe that there is a more direct way to surface real estate gift possibilities. And that is to figure out (through research, brainstorming with staff and board members with institutional memory, etc.) who among your alums/patients/members fits the profile of a likely real estate donor (see IV above), come up with your ten best prospects, and figure out who is best positioned to have a conversation with those persons in the next six weeks.

Often these prospects will be people very familiar to your organization. Sometimes, they won't be.

Whoever they are, our advice is to not be reluctant to initiate a conversation about their real estate holdings and their plans for the future. Rather, I believe it is appropriate to approach such conversations with the attitude that your prospects are likely to welcome a conversation with creative ideas, because it is highly likely that the future of their real estate is very much on their minds these days. My experience is that such prospects are more likely to open up about their real estate and their situation than they are to ask you to stop prying and please go away.

Start with your Board of Directors

Let's start with another quote from John Brown:

> "A real estate gift is sitting at the table of every Board meeting. It's just that no one has ever connected the dots."

I truly believe this.

Which means there are multiple reasons for getting on the agenda of a Board meeting, or at least a Development Committee meeting or a Campaign Committee meeting. They are: You might want to get your Board's blessing on amended gift policies incorporating real estate gifts. You might want to prepare a presentation designed to have the light bulb go off for one or more Board members who perfectly fit the profile of a likely real estate donor. And, you want all your Board members to know enough about the basics of real estate gifts – the *very* basics – that next time they're at a cocktail party and a friend mentions that he's going to have to sell the place on the Vineyard, your Board member needs, at that point, to say: "Before you list it, could I have so-and-so give you a call next week?" rather than say: "Here's the name of a broker you might want to use."

Donor-Friendly Screening and Due Diligence

I have found that concern about environmental risk sometimes totally dominates an institution's thinking about real estate gifts to the point that real estate gifts are rarely sought and, when offered, rarely completed. Though the legal exposures to an organization arising from CERCLA and other laws are substantial and should always be taken very seriously, we believe that

proper screening and due diligence can identify, manage and control these risks – as well as other risks – in most cases.

I am finding many institutions applying a two-step process to evaluating properties offered as gifts. With an emphasis on donor-friendliness (while maintaining rigorous risk management), I believe that a reasonable first step when a potential gift property appears is for a gift officer, or a member of the charity's real estate department (where is exists), to gather basic information in either a site visit (obviously preferable) or in a friendly phone call that might last no more than 30 minutes. Without putting a donor prospect through the ordeal of completing lengthy questionnaires and copying deeds, I have found that the right 30-minute conversation will in most cases provide the essential information needed for a decision on whether or not to proceed with consideration of the gift. The attached data sheet can be used as a guide to what should be a friendly conversation in which this critical information is gathered.

Real Estate Gift Data Sheet

Legal Owner(s) of Property____
Mailing Address ____

____
Daytime Phone Number (___)_________________ Email: ________________________
Person providing information (if other than owner):_____________________________________
Daytime Phone Number (_____) ____________________ Email:

____
Relationship to Property Owner: ____
Address/Location of Property proposed for gift:____

____
Brief description of property: ____

____
_
Land area (acres or square feet):_______________Building area (square feet):

____
Current uses of property:____

____
Abutting property uses:

____
Any obvious environmental hazards associated with property or abutting properties:

____

____
__
Estimated current fair market value of property: $ _________________________
Date of acquisition/inheritance:__________________________
Estimated current cost basis (include improvements): $ __________________________
Amount of mortgage or other debt currently on property (if any): $ ______________________
Has property recently been listed for sale? _____ If yes, with whom, and for what list price?

____
Objectives of donor in wanting to make a gift: ____________________________________

____
__
Gift arrangement contemplated: (outright gift, partial interest, retained life estate, life income arrangement, etc.):

____

____
Is a particular gift designation for a particular purpose contemplated? ________________

____

Note: If possible, please attach a photo of the property and one or more maps showing location and relation to abutting properties.

Development Officer: __________________________**Date:** ____________________

This information, perhaps supplemented by some time on Google Earth, Zillow, and on-line assessor or registry information, is often sufficient for the institution's gift acceptance committee to determine whether the gift would appear to be consistent with policies and meet basic thresholds and not contain any glaring red flags – in which case the decision would be made to proceed to the next and more rigorous stage of due diligence – or whether the gift doesn't meet institutional requirements or has some glaring problems – in which case the decision would be made to tell the donor politely and respectfully that their proposed gift doesn't pass muster.

If the gift passes this initial screening, then it would be appropriate to work with the property owner on the steps of a more complete due diligence process – title search, further market and value investigations, and, in most cases, a Phase I environmental assessment. But there is no need to put either the institution or the donor through these hoops, and incur these expenses, unless an initial screening process provides encouraging preliminary indications.

I'll mention that one trend we are seeing is for more and more institutions to pay for the Phase I environmental assessment – assuming all other aspects of the gift look promising – on the theory that this is a legitimate cost of doing business, akin to paying for title insurance. We have both seen promising gifts go away because of an institution's insistence that the donor – in some cases the donor of a very substantial and valuable property – pay for the $1800 Phase I because "that's our policy."

Menu of Ways to Dispose of Property

Familiar Approaches

In my experience, notwithstanding the education and experience of the professional advisory community – attorneys, CPAs, financial advisors, real estate advisors and brokers – an owner of property, when seeking advice on how to dispose of a piece of (usually appreciated) property, will most often be advised to consider one of three approaches:

- Find the best broker you can, sell for the best price you can get, pay your capital gains taxes, and move on with your plans, including our charitable donation plans; or

- Leave the property in your estate, leaving it to your executor and your children to sort it out when the time comes (whether or not your children really want either the property or the headache of dealing with it); or

- Bequeath the property to one or more charities of meaning to you through your will.

Charitable Approaches

It is less often, in my experience, that a family's advisors will refer to a range of charitable options also available at the time one starts to think about disposing of property. Therefore, more often than not, it falls to the gift planning officer, or major gifts officer, to review the menu of charitable options available to someone contemplating disposing of real estate.

The menu includes:

- Outright gift. Never underestimate the capacity of a donor to make an outright gift. Don't start off assuming, for example, that they will want life income as part of the arrangement. The outright gift is the simplest gift for all involved, provides the maximum and earliest financial benefit for the charity, and provides the maximum tax benefit for the donor.

- Part sale, part gift. For donors not wanting to give the property away entirely but wanting some sales proceeds as a lump sum (as opposed to coming in the form of trust payments or annuity payments), there are two structures that can be adapted to fit a wide range of situations.

    - Bargain sale. A property owner selling their property to an exempt non-profit organization at a price below the appraised fair market value of the property is entitled to a charitable deduction for the difference between the sales price and the appraised value. The deduction from this gift portion can often be used to offset the exposure to capital gains tax on the sale portion of the property. A charity contemplating such a transaction will need access to working capital to cover its purchase price and holding costs prior to the time it sells the property (unless simultaneous sales are arranged.)

    - Fractional interest sale. A property owner may elect to donate an undivided fractional interest in a property to a charity, at which point, typically, the two parties cooperate in marketing and selling the property. The donor is entitled to a charitable deduction based on the percentage of ownership they donate (sometimes adjusted to reflect the minority discount rule). At the time of sale, net sales proceeds are distributed to the donor and to the charity based on their respective ownership shares. The advantage of this arrangement for the charity is that it doesn't require upfront capital for purchase.

- Life income arrangements. Depending on the desires of the donor, and the policies and flexibility of the charity, either a Charitable Gift Annuity or Charitable Remainder Unitrust or a can be used to provide the donor with a combination of deductible gift and income for life or for a period of years (in the case of a CRUT).

- Charitable Gift Annuities. Despite today's low CGA rates, many donors seeking to make a gift of property in exchange for retirement income prefer the CGA solution over the CRUT solution, because of the attractiveness of fixed rates and the relative simplicity of the CGA. In response, more and more charities are deciding that in particular circumstances they would be willing to fund a CGA with property, provided they can defer payments and adjust the pay-out rate to reflect their likely actual proceeds from sale, net of expenses.
- Charitable Remainder Unitrust. Many donors are very well-served by their decision to fund a CRUT with donated real estate. Donors need to understand from the start that they will likely be asked to make cash contributions to the CRUT to cover the CRUT's costs of property ownership prior to sale. Some donors prefer to, or are willing to, serve as initial trustee of the CRUT, through the time of sale, at which time often trusteeship is assigned to the charity. (This approach limits the charity's risk exposures.) More and more donors, however, are asking the charity to serve as trustee from the outset, out of a desire to off-load the responsibilities of marketing the property. In response, more and more non-profits have grown flexible about trusteeship arrangements on real estate funded CRUTs.

- Continued use of the property – Retained Life Estate. The ability to donate a residential or agricultural property while retaining the right to continue using (or, perhaps, renting out) the property provides a very attractive gift vehicle for many property owners. The charity needs to be very careful about the drafting of a detailed side agreement – in addition to the language of the deed itself – that clearly spells out the responsibilities of the parties and anticipates such events as incapacity, need for major capital improvements, etc. Where a non-profit knows that a donor has left a property to them through their estate, they would be well-advised to explore with the donor the advantages of doing the gift as a retained life estate instead – they could still continue to use the property (and be responsible for its costs), but they would benefit from a charitable contribution income tax deduction (unlike a bequest) and could be recognized for their gift during their lifetime.

- Life income and continued use of the property. In certain situations, for some institutions, it makes sense to work with the donor to combine a retained life estate with a charitable gift annuity. Essentially, rather than take a deduction for the gift portion of the retained life estate, the donor uses that value to fund a CGA. The institutions that find the upfront cash necessary for CGA payouts are often institutions that conclude that such an arrangement is a prudent use of endowment funds, where the likely return on investment using funds in this way is competitive with alternative uses of those endowment funds.

- Passing the property to heirs - Charitable Lead Trust. Where a property owner wants to pass on income-producing real estate to heirs in a tax-advantageous manner, while providing interim gifts to charity, the Charitable Lead Trust can be an ideal solution.

- Conserve the property. When working with property owners desiring to either protect conservation-worthy land or to protect the façade of a historically significant building, conservation/façade easements can be used in combination with any of the gift vehicles above. For example, the owner of conservation-worthy land valued at $1 million could either donate the land to his/her college, which would sell it knowing that it would likely be developed; or, the owner could first donate a conservation easement to a local land trust (triggering, say, a $400,000 deduction), and then donate the easement-encumbered land to the college, triggering an additional deduction of, in this instance, $600,000. In the second situation, the College would sell the property and yield $600,000 from the gift. In both situations, the donor would be eligible for deductions totaling about $1 million.

CASE STUDY ON USE OF REAL ESTATE TO FUND CGA

Husband and wife in their early 80's approach two national charities to make a donation. The husband had been a college professor, they had no children, now living in a retirement facility, needed additional income and wanted to leave major gifts to the two organization.

The donation asset was a cabin on four acres of beachfront property in Rhode Island. The donors estimated the value to be in the $750,000 range and there existed a small mortgage. The property was purchased in the early 1950s and the family used it as summer retreat and to entertain guests. At present it produces no income and if sold would net considerably fewer dollars for reinvestment from which they would hope to get an income stream. At any rate "safe" investments were producing between 1.5% and 3% or roughly $15,000 in annual income.

The Planned Giving Officer for one of the charities suggested and exchange of the property for a Charitable Gift Annuity at a fixed rate of 8.3% annually. This would produce an annual income of $41,500 plus provide tax saving from the gift deduction this arrangement. For six years the deduction help shelter the income stream and effectively increased the net payout return to around 12%.

The organization entered into a join agreement to share the donation. The property sold for over $1,200,000 including sales and marketing fees. The donor's annual annuity payment jumped to $83,000 because of the increased value of the gift and net sales proceeds.

All parties to the transaction were happily surprised by the end result. The charities get major gifts, the donor fulfill their philanthropic goals and protect their retirement years with a secure commitment for a lifetime income.

Bargain Sale of a Restaurant site

An investor owned a property for over 30 years that included a 19,000 square foot building and the land on which it sat (46,000 square feet). In previous life the property had been used as a site of an upscale restaurant and offices. During the period in which the property was fully occupied it had an appraised value of $2,100,000. The property went vacant for five years. During that time, it was offered for sale at $1,100,000. The Donor continued to carry mortgage payments on $350,000 plus annual holding costs for property taxes of $18,000; insurance and public utility stand by charges of $5,000.

A two-year-old appraisal in the approximate amount of $1,050,000 had been commissioned by the Donor and he felt the FMV would still be in that range.

Enter Realty Gift Fund (RGF) a 501 (c) 3 public charity into discussion with the property Owner/Donor about the potential for a “Bargain Sale” donation arrangement. A “Donation Agreement” was signed by both RRGF and the Donor. The terms included a provision for RGF to pay the Donor $350,000 in cash at closing. The Donor would use these funds to retire the mortgage leaving the property free and clear for RGF. (FMV $1,050,000 less $350,000 mortgage leaves RGF with an indicated equity/donation of $700,000).

RGF arranged for an investor to lend it the $350,000 needed to close with the Donor. The new mortgage had a term of three years with interest and equity participation to be paid at the closing of a sale to any new purchaser of the property.

The donation closed on June 8th. A sale to third party buyer closed on June 23rd. At closing the investors mortgage was paid off and RGF got the residual of the sale proceeds as the fundraising benefit for RRGF from the “Bargain Sale” donation.

The buyer was a local restaurant chain that paid cash for the property. It had no use for the improvements so all of the buildings will be demolished to make room for a new restaurant. The

sales price was reduced to allow the buyers to complete its plans. By quickly finding a buyer and reducing RGF's risk exposure it captured major cash gift from this process.

Benefits of the Transaction:

1. Donor received debt and holding cost relief
2. A charitable gift deduction flowed through to the Donor
3. RRGF received funding for their primary mission (environmental impacts property remediation) and education on its expertise leading to the public good, i.e., repositioning property for new uses and adding to the community tax base
4. The third party's Realtor got a full 6% commission

RRGF is flexible on structuring these types of donations. The cash purchase portion does not have to be used for debt reduction. Should the property be free and clear, the Donor can take the cash for his/her benefit.

This gift arrangement offers creative solutions for a Donor and the property can be donated anywhere in the United States.

Case Study CGAs funded by Rental Property

In the world of charitable gifts, real estate donations provide a way to benefit both the donor and the charity. When a Donor decides to make a gift of real estate to a Charity, the gift can be combined with a Charitable Gift Annuity that ensures the Donor a guaranteed monthly income for life and the Charity with the remainder upon the death of the Donor. In the example of the successful case study below the Charitable Gift Annuity was also complemented with a direct donation to the charity. Both parties were very pleased with the results.

Mr. and Mrs. Donor of Torrance, CA, approached California State University Dominguez Hills (CSUDH) to explore the possibility of donating a condominium in Redondo Beach, CA to support the housing needs for new professors. While investigating their concept, it was suggested they might want to consider using a portion of their property equity to fund a Charitable Gift Annuity (CGA) which would provide them each with a fixed monthly income and use the balance as an outright gift to the university.

To accommodate the CGA element of the donation it required the California State University Foundation (CSUF), a certified grantor of CGAs, to step in as the transaction's coordinator. Two officers from the school's Advancement office worked together to process the procedure prescribed in the university's "Guidelines for Gifts of Real Estate".

The university retained me as their real estate consultant to handle the joint efforts of several strategic alliance partners with whom I had built relationships. The Financial Company provided a qualified realtor to inspect the condo, order a preliminary title report, write a "Brokers Opinion of Value" memo and issue a marketing plan. Under the university's guidelines, all properties offered in exchange for CGAs must be donated and sold simultaneously.

The Realtor procured an acceptable purchase offer. The escrow closing took only twenty-five days. Everything went as planned and sales proceeds were distributed to fund two CGAs (one each for Mr. and Mrs. Donor) as well as a current cash gift to the university. The cash was to be used to purchase one or two condos near the campus that would be used to house university professors.

When interviewed about the process, Mr. Donor said, "the process went very smoothly" but "it needs to be better advertised". He sensed that many other university supporters would use their real estate equities to fund CGAs if information were better disseminated.

Comments from a University representative, "Our foundation board was cautious about accepting gifts of real estate because we do not have a sizeable unrestricted asset pool to capitalize a Charitable Gift Annuity while marketing the real estate for sale. The process of simultaneous sale eliminated that obstacle and the risk associated with estimating sale proceeds."

In the process of simultaneous sales, the donor enters into an agreement giving the charity a contractual right to the donation. Under that contract the charity has a specific due diligence period to investigate the property issues and market the asset. It is the Foundation's consultant that finds the buyer, negotiates the sales price and closes the transaction. The Donor receives the gift annuity income and tax deduction component at the end of the process.

They have no hands-on control of the process once the "Agreement for Donation of Real Property and Escrow Instructions" has been executed.

This type of gift is an excellent opportunity for philanthropic donors to be active participants in the distribution of their estate experiencing the gratification of seeing their dreams realized while

at the same time receiving the financial benefit they needed from the donated asset.

Sidebar example: the values are for demonstration purposes and not actual case numbers.

Fair Market value of property:	$500,000
Costs for sale: 7%	$35,000
Net sales proceeds:	$465,000

The Donors fund a CGA for $375,000 at an annuity rate of 6.25% or $23,437.50 annually and receive monthly annuity payments of $1,953.13, guaranteed for life! (Annuity rates are based on the American Council of Gift Annuities.). The Donor wins – they now have an income stream greater than they were receiving from the property's rent, in addition, they are recognized for their lifetime philanthropy to the University.

The balance of the donated property equity of $90,000 could be a straight current gift to the Charity.

Solution for Prearranged Sales

A donor approached a fundraising staff member at The George Washington University with an offer to donate her rental condominium. She was very excited because it was under contract to sell the unit for $550,000 with closing to take place in ten days. A policy within the University requires fundraisers, when dealing with potential real estate donations, to work with a member of the Planned Giving Department. At the first joint meeting with the donor the University's team had to raise the pre-arranged sale issue.

The donor was advised that the University would be happy to receive the gift, but under the circumstances, the donor would be subject to a huge capital gains tax (The basis in the property was $50,000). This was not a good message to carry to the donor. She did not understand why the University would not accept the gift and give her full gift credit. The initial gift of the condo was to be the first of two gifts toward an ultimate gift of a $1,000,000 endowed scholarship. She wanted to add the equity in the second condo to the pool for the endowed fund. Any difference between the equities in the real estate gifts and the $1,000,000 would be made up for by a provision in her will. Losing credit for the first transaction was not an option if the University wanted to save this wonderful donation.

The team of accountants and attorneys involved in the original purchase agreement came up with a solution. The donor and purchaser agreed to amend the purchase agreement to allow the seller/donor/exchanging party to add a provision for an IRS Section 1031 exchange.

The purchase of the condo was completed as planned. The net proceeds from the closing were placed into an escrow account controlled by a facilitating agent. The University has on staff a nationally known specialist in exchanges. With his expertise, a replacement property was located and purchased within his guidance of the Starker provisions as dictated by the IRS. ***Starker exchange case as a footnote.

Once the replacement property was closed, the donor leased the property for a short period of time and decided to move forward with a "Donation Agreement" that had a "Bargain Sale" component. The Bargain Sale first went to reimburse the Donor for costs related to the first property transfer into the exchange pool.

The University advanced funds for repairs to the replacement property. The "Bargain Sale" agreement provides for these costs to be reimbursed to the University, the donor to get her money, and the gift to be booked at very nearly the face value of the original property value when it was first offered as a gift.

A buyer was located for the replacement property and closing took place. Funds were distributed to each party as the donation agreement spelled out.

End Results:

1. Happy Donor
2. Happy University
3. Happy purchasers for both properties

To use this technique, the property offered as the donation must meet the IRS criteria as "like-kind" property. The Starker provision requires that a donor and his/her agent must comply with this or use the simultaneous closing technique.

The professionals who play a role in this type of arrangement are:

1. Tax attorney
2. CPA
3. Title company officer
4. The charity's general counsel
5. A facilitating agent
6. Realtor with section 1031 exchange experience

*** **Starker v. United States**

STARKER v. UNITED STATES

79-2 U.S.T.C. ¶ 9541 44 AFTR 2d 79-5525 (1979)

Affirming, reversing and remanding 77-2 U.S.T.C. ¶ 9512 (1977), 40 AFTR 2d 77-5460 (1977)

Creative Structural Alternatives to Isolating and Managing Risk

Charities have several options for avoiding most liability when they are offered real estate assets.

One option, referred to above, is for the gift to come by way of a charitable remainder trust where the charity does not assume the trusteeship until the property has been sold by the originating trustee.

Another option is to enter into an arrangement with a "facilitating charity" to accept the role of processing a donation and then sharing the net proceeds once the asset is sold. No ownership issues are linked to the originating charity by structuring a mutually beneficial arrangement on how to handle real estate being offered by the donor. Some community foundations provide this service, as do some colleges, universities, Realty Gift Fund and Charitable Solutions.

Some non-profits have elected to establish a 509 (a) (3) charitable supporting organization, for the purpose of receiving and disposing of gifted real estate, with the expectation that income and assets in this organization could be distributed to the sponsoring charity at any time.

Another approach, popularized by attorney Emil Kallina, is for the charity and an identified buyer enter into a "put" option agreement whereby the charity can elect to postpone taking title to the gifted property until such time as it intends to exercise its option to sell the property to the identified buyer. Though this leaves the charity in the chain of title momentarily, it eliminates any exposure to carrying costs, etc.

Two other approaches, the directed/simultaneous close, using guidance from the Tax Court's *Guest* ruling, and the use of single member limited liability companies, are described below.

The Directed/Simultaneous Close

A directed close is a means by which a charity accepts, markets, and sells a gifted piece of real estate without taking title to the property, while still providing the property's donor with access to an income tax deduction. In such a transaction, the title and deed to the gifted property convey directly from the donor to a third-party buyer without the charity having ever taken title. By remaining outside the chain of title, the charity avoids any risk exposure to environmental concerns, injury to visitors to the property, and/or downturn in property values while the gifted real estate is on the market or after it is sold. In addition, the charity assumes no responsibility for holding costs that may apply to the gifted property, including property taxes, maintenance, insurance, etc. This enables charities to accept a much broader range of gifts and helps maximize the donor's tax deduction.

The legal precedent that underlies the directed close technique

In *Guest v. Commissioner,* 77 T. C. 9 (1981), a charity never took title to several gifted pieces of real estate, yet the donor, Winston F. C. Guest, was entitled to a charitable deduction for his gift. The charity wanted title to convey directly from Mr. Guest to a third-party purchaser in order to minimize the applicable state and local transfer taxes, which, without a directed close, would have applied first to the transfer from Mr. Guest to the charity and again to the transfer from the charity to the third-party purchaser, thus significantly diminishing the proceeds of the gift.

In *Guest*, the charity requested Mr. Guest to "retain title as nominee on our behalf. When we have completed our negotiations (for resale of the properties), we will instruct you to prepare deeds in the name of the purchaser." During the "inspection period," the charity identified a willing and able buyer and directed Mr. Guest to transfer the properties' deeds to the third-party purchaser. While the IRS held that this transaction did not entitle Mr. Guest to a charitable deduction, the Tax Court strongly disagreed and held that, where the parties' intentions to make and accept a gift of property are clear and well-documented, a donor can be considered to have made a valid charitable contribution of real estate when the donor deeds the property not to the charity, but instead, at the charity's specific direction, to a third-party buyer identified by the charity.

This ruling was further reinforced in 1986 in *Stark v. Commissioner,* 86 T.C. 243, in which a taxpayer desired to transfer land worth $1.8 million to the U.S. Forest Service. The Forest Service can receive contributions of land only by exchange but, in *Stark*, the donor wanted to receive cash. So, the donor/seller agreed to sell her property for $1.2 Million to a third-party purchaser, who would then exchange that property for other Forest Service property; the donor/seller would also receive a $600,000 tax deduction for the discounted price. Citing *Guest*, the court held that the contribution to the Forest Service was complete when the taxpayer conveyed the property to the third-party buyer pursuant to the Forest Service's direction, and not at the later time when the Forest Service completed its exchange transaction with the third party as urged by the IRS.

How it works

Underlying each directed close transaction is a legally binding gift agreement, or contract, in which the donor makes an irrevocable commitment to convey to the charity title to the gifted piece of property, subject only to an "inspection period" for a stated period of time. During this period, the charity inspects and markets the property and attempts to identify a third-party purchaser. Throughout the inspection period, the donor remains responsible for all holding costs associated with the gifted property, including maintenance, taxes, and insurance. The donor also remains responsible for all warranties and representations set forth in the agreement in regard to the gifted property and agrees to indemnify and hold harmless the charity from and against any liabilities or claims of an environmental nature.

If a third-party purchaser is identified, a closing settlement is scheduled. At closing, the donor/seller is directed by the charity to convey the title and deed directly to the buyer. The

donor receives a tax deduction equivalent to the tax deduction s/he would have been entitled to if s/he had transferred the title directly to the charity.

If a third-party purchaser is not identified, then one of three things will happen:

1. The charity and donor may choose to negotiate a new gift agreement, perhaps with different terms;

2. The charity may choose to finish accepting the gift and take possession of the property; or

3. The charity may let the contract expire, so that full control of the property reverts to the donor.

The Single Member Limited Liability Company

Recently, the IRS has come forward with guidelines which allow charities to create single-member limited liability companies (SLLC) into which title of donated properties may be placed. This approach offers a safe haven for the charity while allowing the donor to get credit for the charitable deduction.

By using this approach as an alternative to simultaneous closings or support organizations, the charitable world is being offered an inexpensive way to start accepting real estate donations.

Some large national charities are reviewing the concept with the hope they can expand their fundraising efforts by creating a barrier to risk factors sometimes associated with real estate gifts.

Conclusions

I believe that the development community will continue to show an increased interest in the pursuit of real estate gifts, as gifts of cash and appreciated securities remain hard to come by. I believe that more and more development shops will take advantage of the accumulated wisdom and best practices available for the pursuit, structuring, evaluation, closing and disposition of real estate gifts.

I also believe that more and more development shops will overcome the “chicken and egg” paralysis that has often stood in the way of pursuit of real estate gifts. By this I mean: Some organizations have been reluctant to publicize an interest in real estate gifts out of concern that they would get many inquiries and wouldn’t have the capacity to deal with them. Other organizations have been reluctant to develop their capacity – through policies and procedures, staffing and staff training, consultants – to process real estate gifts because they have been afraid that there might not be the volume of real estate gift activity to justify such an investment. My advice is: Ramp up slowly on both sides. Do a little bit to develop real estate gift capacity, and do a little marketing, and see where it goes. If a decent level of real estate gift activity

materializes over time – and it takes patience, it won't happen overnight – then gradually investing more might make sense.

But I don't think it's a good idea to do nothing, and meanwhile watch one's peer institutions enjoying real estate gift success.

Just get started or increase your existing efforts. And proceed carefully, intentionally, and with a sense of optimism that your efforts will produce substantial results over time.