HOW TO PURSUE AND ACCEPT THE RIGHT REAL ESTATE GIFTS

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I. Introduction and Objectives

In today's session we 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. We 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. We will illustrate the use of various gift structures, and the application of best practices, in a review of five case studies – real estate gifts we have personally worked on in recent months and years. Finally, we will review alternative approaches to structuring real estate gifts – alternatives used primarily to better manage some of the risk inherent in real estate gifts.

We want attendees to leave with a better understanding of the potential and practice of real estate gifts. Specifically, we 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.

We hope many attendees will be convinced that attracting and closing the right real estate gifts is not rocket science, and is not an esoteric discipline to be left only to the largest of institutions. We 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. We 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.

We 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, we 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.

We 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.

II. Review of Trends in Real Estate Gifts

It has been our experience – Chase in his work at George Washington University, Dennis 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.

We ascribe several explanations to this recent trend. First, we 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.

We 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, we 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 our 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.

III. 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. According to the Urban Land Institute, real estate comprises 43% of household wealth in the United States – some $27 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. In 2005 (and there is no reason to believe the basic pattern would have changed substantially) 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. We 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, we 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.

IV. What Real Estate Donors Look Like, and What Motivates Them

So, we 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?

Two studies in recent years – one of the membership of PPP (then NCPG), and one of the membership of Planned Giving Group of New England – asked gift officers involved in real estate gift transactions what appeared to be the motivation of real estate donors.

Both 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.

V. What Today's Real Estate Gifts Look Like

From surveys we 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 our 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 is a summer home or a factory.

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 2009 returns – tells us that slightly over $5 billion in real estate donations were reported in 2009. (This includes conservation easements and façade easements). In that year the average (mean) real estate donation was reported as $466,000. This number has declined in recent years, but it is still a substantial number for the *average* real estate gift.

Significantly, we know from this study that real estate donations for donors age 65 and older (where most of the donation activity is) was about $585,000.

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 $500,000, isn't it worth a little effort and expense to bring in such gifts?

We are also asked if it's true that many properties offered as real estate gifts are encumbered with mortgages. Our 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.

VI. 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.

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

One excellent source of these Best Practices is the survey conducted by PPP (it was then the National Committee on Planned Giving) in 2008 of its members concerning real estate gift trends and practices. That study has allowed us to focus our attention on just those institutions (13% of total respondents) that reported that in recent years 10% or more of their total contributions – measured in dollars – came from real estate gifts. In other words, we were able to look at those policies and procedures and practices common to those development departments that enjoyed the greatest success in the field of real estate gifts.

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

a. Policies and Procedures

We 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 tool box 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.

b. Marketing

We are 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."

We 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. We have some creative 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.

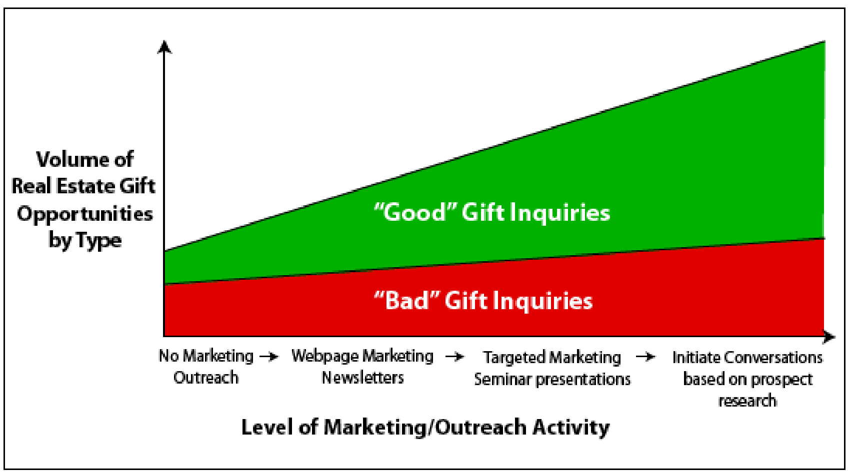
No matter what the message and the medium, it's critical that the organization's response be timely, friendly and professional. As we suggested before, there's no point in launching a sophisticated marketing program if the response is to fire off a request to complete a lengthy questionnaire and send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

c. 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.

It is our experience that the more initiative the non-profit takes in seeking out real estate gifts – through marketing, and better yet by initiating conversations with likely prospects – the more likely it is that the potential real estate gift that surfaces will be high-quality and high-value. With no outreach whatsoever, the occasional random real estate gift opportunity might surface, but with increaased likelihood that the property offered is not high quality. As outreach efforts are undertaken, there will still be some unattractive gifts offered up, but the likelihood of "good" real estate gifts increases dramatically.



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, we 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. Our 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.

d. 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."

We 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."

e. Donor-Friendly Screening and Due Diligence

We 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.

We are 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), we 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, we 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.

As an aside, we'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."

VII. Menu of Ways to Dispose of Property

a. Familiar Approaches

In our 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

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

b. Charitable Approaches

It is less often, in our 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.

VIII. Case Study #1: Outright Donation of Corporate Surplus Property

A major US manufacturer owned a 100,000 sf. factory, situated on 47 acres of land, in the southeastern US. The facility, vacant for several years, required in excess of $100,000 per year in holding costs for the corporation.

The company's appraisal valued the property at $2,250,000, a price potentially attainable with a marketing time of 30 to 36 months.

The company became interested in donating the property to a charity as an alternative to continued holding costs and uncertain sales price. National Emergency Medical Association was interested in pursuing the donation possibility, provided their due diligence investigations checked out.

When all was said and done, the NEMA took title to the property, and was able to sell it for $600,000 within ninety days.

The corporation claimed a charitable deduction of $2,250,000, based on its qualified and current appraisal. An IRS audit produced no challenge or adjustment to the donation.

IX. Case Study #2: Outright Donation of Family-Owned Farm to a College

A 1944 graduate of Mount Holyoke College, Mrs. Mueller, living in Chicago, owned an 80-acre farm in southern Illinois, inherited from her parents many years ago. The advantages of continuing ownership – steady rent payments, sentimental attachment – were being overtaken by the burdens and worries of long-distance property management. When her CPA helped her estimate the capital gains tax that would be due if she were to sell the property, she instead contacted her alma mater about the possibility of making a gift of the farm. She was aware from the alumna magazine of Mount Holyoke's interest in accepting gifts of real estate.

The College decided that it would be possible, though not certain, to comply with Mrs. Mueller's desire that the gift be completed by year end. (The initial contact came in October.) Subject to due diligence investigations, the College gave preliminary approval to accepting the gift.

Title search, Phase I environmental investigation, and study of local market conditions all came out positive. Working with a local attorney, the College and Mrs. Mueller completed by year end the deeding over of the property. In a very strong market for farm property, the property was auctioned off early the next year at a price in excess of the value estimated by the appraisal commissioned by Mrs. Mueller.

Mrs. Mueller was able to simplify her life, was able to avoid the capital gains tax she would have paid had she sold the property, she was able to claim a substantial tax deduction for the gift, she did not have to worry about selling the property herself, and she was very pleased to know that her very generous contribution would fund scholarships at Mount Holyoke.

Note: Mrs. Mueller had only made sporadic modest gifts to her alma mater over the years. She had not been identified as a major donor prospect through wealth screening. She wasn't on the College's radar screen at all. But she fit the profile of a real estate donor: over 70 years of age, owned multiple properties at some distance to one another, no children.

X. Case Study #3: Bargain Sale of an Apartment Complex

Owners in Albuquerque, New Mexico, had a 40-unit apartment complex with multiple problems. The issues facing the owners and their management firm were:

1. 30% vacancy factor
2. Tenants in various governmental subsidies programs weren't compatible with other tenants
3. There was a history of late rental payments and subsequent court action
4. Numerous drug arrests had occurred involving both the tenants and their guests
5. An existing mortgage of $290,000 was virtually non-assumable or owners had to remain as guarantors
6. Owners basis (property acquired via Section #1031 exchange) of $100,000
7. Location in high crime area
8. The tenants have physically abused property i.e. car destroyed one corner of a building, and unreported water leaks
9. Owners were moving to Mexico to complete a retirement home. The construction project demanded additional funding very quickly or all work would be stopped.
10. Monthly negative cash flow occurred in spite of the owners donating their time to management, repairs, leasing and regular appearances in court on pending eviction litigation.

The owners agreed to donate their equity over and above the cash necessary to retire the mortgage and provide funds to complete the construction of their Mexico home. The balance of the property's value was to be contributed to a charity. The parties entered into a "Bargain Sale" contract in which the charity agreed to pay the donors $500,000. This would allow the donors to pay off their $290,000 mortgage and have a $210,000 cash balance.

During the charity's due diligence period they found a qualified buyer for the complex. It was the buyer and charity that negotiated the terms of the sale. Both transactions closed simultaneously which allowed charity to use the third party's money to close on their purchase from the original owners. The donors got released from the mortgage obligation, $120,000 in cash, a second mortgage for $90,000 and a charitable gift deduction of $500,000 based on the appraisal of $1,000,000.

By identifying properties with low basis, philanthropic owners and their professional advisors can craft creative solutions to apparent problem situations, all parties, therefore, benefit from the outcome.

XI. Case Study #4: CGAs funded by Second Homes of Retirement Community Residents

The Kendal Corporation, a non-profit organization that operates Quaker-based retirement communities throughout the country, decided to begin promoting the possibility of real estate gifts from the residents of its communities. Kendal Charitable Fund – which operates centrally to serve all of the communities -- would provide assistance and working capital when real estate gift possibilities emerged.

This initiative grew out of the recognition of many local communities that many of their charitably-minded residents continued to own real estate – typically vacation homes – after they had sold their primary residences and moved in to the Kendal community.
In its review of gift acceptance policies, Kendal determined that under certain circumstances it would accept real estate assets to fund Charitable Gift Annuities. It turns out that this vehicle was of considerable interest to several community residents.

In a short period of time, deferred CGAs were funded with a vacation home in North Carolina (for the benefit of the Kendal community in Granville, OH), and a vacation home in Virginia (for the benefit of the Kendal community in Lexington, VA.)

In one instance, the property was sold to an abutting property owner who had long been interested in the property. In the other instance, the property was sold through a local broker.

In both cases, the properties sold long before the first CGA payments were due. In both cases, the annuity contracts were based on the property value as determined by the donors' appraisals, and in both cases CGA rates were adjusted downward to reflect conservatively projected sales prices and carrying costs.

Note: At the time that these CGAs mature, the central Kendal organization will recover its costs, with the balance of proceeds being distributed to the respective local communities.

XII. Case Study #5: Retained Life Estate with Texas Ranch

Houston residents and long-time members of National Wildlife Federation had decided they wanted to make a gift of their ranch and vacation home, which they used as a get-away for bird-hunting, provided they could work out an arrangement to continue using the property. When they contacted NWF, it was clear that the organization had the expertise to put together such a transaction.

The property had mineral rights with considerable value, which would be part of the gift.

After considerable title work was completed, and a Phase I environmental assessment, and a property survey, the gift was completed: The initial donation was a 50% undivided interest in the property, subject to a retained life estate. (A carefully thought through retained life estate agreement spelled out the details.) The fractional interest gift was based on the appraised value and a determination that the gift should be spread out to maximize the value of the deductions.

Note: The parties entered into an enforceable pledge agreement requiring the ranch owners to donate the remaining 50% interest in the property no later than six years from the date of the initial gift. Thus, NWF was assured that it would not be left with an unmarketable fractional interest in a Texas ranch.

XIII. 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 and universities.

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.

XIV. 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.

XV. The Single Member Limited Liability Company

Recently, the IRS has come forward (Notice 2012-52) 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.

XVI. Conclusions

We 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. We 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.

We 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 we 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. Our 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 we 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.