Vacation Homes and Ranches as Charitable Assets

Santa Fe Community Foundation
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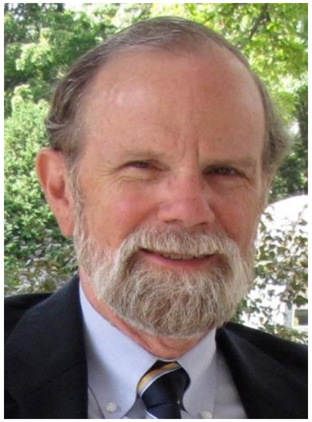
Dennis Bidwell, MBA
Elizabeth Roghair, CPA

Presented by:



Dennis Bidwell
Principal
Bidwell Advisors

Elizabeth Roghair, CPA
Santa Fe Gift Planning Coach

Review of topics

- Recent real estate gift trends
- What real estate wealth looks like these days
- A profile of today's real estate donor
- A profile of today's real estate gift
- The menu of ways to dispose of property
- Case Study 1: Outright gift of an Aspen condominium

Review of topics

- Case Study 2: A Texas ranch and a retained life estate
- Emerging best practices for real estate gifts
  - Gift acceptance policies and procedures
  - Marketing, and initiating the conversation
  - Risk management through screening and due diligence
- Final thoughts

Recent Real Estate Gift Trends

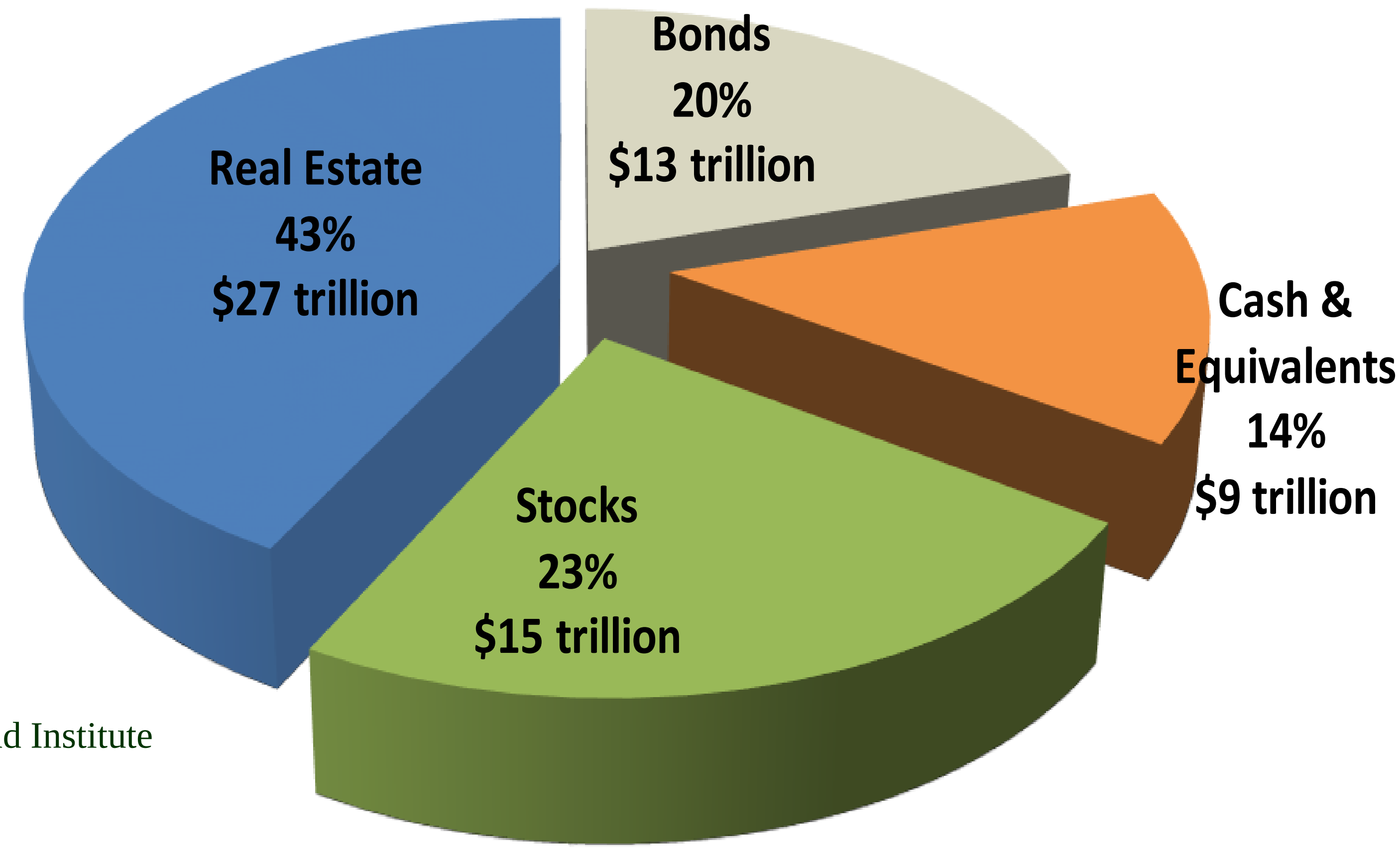
- Development offices increasingly turning their attention to real estate.
- Anecdotally, considerable increase in real estate gift activity in the last 3 to 4 years.
- Growing recognition that real estate is the single largest asset category for American households. ***It's a huge component of the intergenerational wealth transfer that surrounds us.***
- Major gifts of cash and appreciated securities remain hard to come by – many donors want to retain their liquidity.

Recent Real Estate Gift Trends

- Dramatic increase in marketing of real estate gifts.
- An increasingly accepted set of best practices regarding real estate gifts, providing comfort level to previously-wary institutions.
- A substantial increase in attention to real estate gifts in journals, conferences and popular press.
- Many, many aging property owners are looking to dispose of property – *and only some of these properties are problematic.*

What Real Estate Wealth Looks Like These Days

- Real estate is the single largest asset category for American households.



Source: Urban Land Institute

What Real Estate Wealth Looks Like These Days

Much of this Wealth is in Second, Third, Fourth… Homes

- **In 2005, 1 in 10 households owned 2 or more properties**
  - **1 in 25 owned 3 or more properties**
  - **39.9% of 8.4 million homes sold were "second" homes**
    - 27.7% owned for investment purposes
    - 12.2% owned as vacation homes

- ***"Among property owners 50 and older, 18% of them will sell a piece of real estate in the next 18 months"***

  – John Brown

Source: National Association of Realtors, 2005

What Real Estate Wealth Looks Like These Days

And much of this real estate wealth is controlled by out-of-state owners:

- The percentage of housing units in New Mexico used for seasonal or recreational use is almost a third greater than the national average, and increasing (per 2010 census).
- Santa Fe continues to be a popular choice for second home buyers, not only from Texas, California and New York but more recently from Oklahoma, Washington, Illinois, Maryland and Connecticut.

A Profile of Today's Real Estate Donor

Motivations of the Real Estate Donor

• Availability of Tax Deductions	64%
• Relief from headaches of owning/managing real estate	62%
• Charitable intent	60%

Source: Survey of Membership of Partnership for Philanthropic Planning

A Profile of Today's Real Estate Donor

Composite Profile

- Age 65+.
- Own 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.

A Profile of Today's Real Estate Gift

From 2010 Tax Returns:

- $5.45 billion in real estate donations in 2010 (fair market value, including conservation and façade easements).
- Average size real estate donation was $296,000.
- For real estate donors 65 and older, the average real estate donation was $498,000.

Also,

- For persons over 65 years of age, 83% of their real estate is debt-free.

Source: IRS, "Individual Non-Cash Charitable Contributions, 2010" ; Statistical Abstract of U.S.

A Profile of Today's Real Estate Gift

Types of Properties Reported Given:

Second/vacation homes and rental residential properties	30%
Primary residence	20%
Undeveloped land	17%
Commercial properties	12%
Farms and ranches	12%
Land with conservation value	3%
Time shares	2%
Industrial properties	1%
Other	1%

Source: Survey of Membership of Partnership for Philanthropic Planning

The Menu of Ways to Dispose of Property

Property Disposition – Familiar Approaches:

- Sell the property, pay the capital gains taxes, invest the proceeds, and move on.
- Pass the property on through the estate, let the kids figure it out.
- Donate it outright, or by bequest, to charity.

The Menu of Ways to Dispose of Property

Property Disposition – Charitable Approaches:

- **Outright gift (Case Study 1**) – *Where there is capacity and desire for simplicity*

- **Part sale, part gift** – *Where donor needs to retain some of the value, preferring a lump sum*
  - Bargain sale (part donation, part taxable sale)
  - Fractional interest gift

- **Life income arrangements** – *Where donor needs to retain some of the value, paid out over time*
  - Charitable remainder trust funded by real estate
  - Charitable gift annuity

The Menu of Ways to Dispose of Property

- **Continue using the property (Case Study 2) – *Where donor is ready to make the donation decision, and wants current income tax deduction***

  - Donate remainder interest in property, retaining life estate

- **Life income and continued use of property** – ***Where donor wants to commit to donate, but prefers stream of payments with smaller deduction***

  - Charitable gift annuity with retained life estate

- **Pass the property to heirs - *Well-suited for income-producing property eventually to go to heirs***

  - Charitable lead trust

- **Conserve the property** – ***For the conservation or preservation-minded donor***

  - Any of the above can be combined with conservation easement/restriction

The Menu of Ways to Dispose of Property

Real estate gift structures used very or somewhat frequently:

Bequest in a will or trust	51%
Outright gift	47%
Charitable remainder trust	44%
Gift of home or farm with retained life estate	27%
Undivided/fractional interest	19%
Charitable gift annuity	18%
Bargain sale	11%
Retained life estate with charitable gift annuity	6%
Charitable lead trust	5%

Source: Survey of Membership of Partnership for Philanthropic Planning

Case Study 1: Outright Gift of an Aspen Condominium

Outright Gift Basics:

- The type of real estate gift seen most frequently in the last two years.
- Yields the largest possible deduction for the donor.
- Yields the largest possible gift for the non-profit.
- ***Don't underestimate how many people are in a position, indeed motivated, to make an outright gift of real estate.***

Case Study 1: Outright Gift of an Aspen Condominium

Outright Gift Basics:

- Funds are available here and now – as soon as property is sold. Can meet current needs.
- Simplest type of real estate gift for all concerned.
- Can be structured to minimize the non-profit’s holding period.

Case Study 1: Outright Gift of an Aspen Condominium

The New York Charity and the Aspen Condo

- The Charity had several board members with extensive real estate holdings, and shared with the board information on the tax treatment of real estate gifts.
- One board member owned a condominium in one of the first slope-side developments in Aspen.
- He no longer skied, he rarely used the property, and it had become more burdensome than enjoyable.

Case Study 1: Outright Gift of an Aspen Condominium

The New York Charity and the Aspen Condo

- The owner approached the charity's CEO about possibly gifting the property.

- The Charity's development staff, having little real estate gift experience, sought the assistance of a real estate gift consultant.

- An initial step was a preliminary gift acceptance letter, spelling out the gift arrangement and the responsibilities of the parties in moving to a closing.

Case Study 1: Outright Gift of an Aspen Condominium

The New York Charity and the Aspen Condo

- A team was assembled to handle due diligence and other matters:
  - Aspen real estate attorney
  - Building inspector
  - Realtor
- Issues (largely routine) that came up:
  - Radon remediation work was required
  - Homeowner Assn agreements required right of first refusal notification to all homeowners
  - Separate deed for conveying furnishings, furniture, fixtures, etc.
  - etc.

Case Study 1: Outright Gift of an Aspen Condominium

The New York Charity and the Aspen Condo

- Issues (largely routine) that came up (cont.):
  - A deeded parking garage unit needed to be separately conveyed
  - Owner needed to obtain an updated appraisal to substantiate his deduction
  - Transfer over of responsibility for property taxes, utilities, condo fees, etc.
- Marketing produced an early offer
- One other condo owner exercised right to match the outside offer
- Property ultimately sold for over $4 million.

Case Study 2: A Texas Ranch and a Retained Life Estate

Retained Life Estate basics:

- A personal residence or farm/ranch is donated to a charity, with one or more donors (or another party) retaining rights to use the property for life or for a term of years.
- The donor is donating the *remainder interest* (generally a deductible gift), and *retaining (or reserving) a life estate* or *retaining a tenancy.*
- Charity assumes ownership of the property, but not possession.
- A creature of federal tax law – IRC 170(f)(3)(B)(i).

Case Study 2: A Texas Ranch and a Retained Life Estate

Retained Life Estate basics:

- State law must be consulted regarding real estate conveyance, etc.

- The "life tenants" maintain full use and control of the property, along with full responsibility for property taxes, insurance, and normal property maintenance.

- A clear written agreement between donor and charity should cover such matters as responsibility for major improvements, incapacity of the life tenant, vacating the property, etc.

Case Study 2: A Texas Ranch and a Retained Life Estate

Property That Can Be Given

Personal residences:

- Doesn't have to be a principal residence
- Can include improvements and permanent fixtures *(But not tangible personal property, e.g. furniture)*
- Houseboats, mobile home, trailer
- The shares of a cooperative corporation

Case Study 2: A Texas Ranch and a Retained Life Estate

Property That Can Be Given (Cont.)

Farms/ranches:

- Doesn't have to provide income for the owner (i.e. it can be a "hobby ranch" or "country estate")
- Can include improvements and fixtures - barns, houses, silos, etc. (but not farm/ranch equipment and machinery)

Term

- Life of donor(s) or life of other individuals (e.g. a tenant)
- Or, period of years

Case Study 2: A Texas Ranch and a Retained Life Estate

Valuation of the Remainder Interest is Based on:

- Fair market value at time of gift
- Length of time – life expectancy or term of years
- Value of improvements (subject to depreciation) and natural resources (subject to depletion)
- Estimated useful life of improvements
- Salvage value of improvements
- IRS discount rate for month of gift or either of the two previous months (low discount rates increase value of the remainder interest/deduction – especially so today)

Case Study 2: A Texas Ranch and a Retained Life Estate

Retained Life Estate IRS Deduction as a percentage of valuation (approximate)

Single Life	%	Joint Lives	%
56	48%	56, 54	37%
66	61%	66, 64	50%
76	73%	76, 74	63%
86	84%	86, 84	77%
96	91%	96, 94	87%

Assumed discount rate: 2.0%

Case Study 2: A Texas Ranch and a Retained Life Estate

Income Tax Deductions

- For property held more than one year, charitable deductions up to 30% of Adjusted Gross Income
- 5-year carry-forward allowed (use of partial interest donation can effectively extend this carry-forward period)
- Charitable deduction claimed on Form 8283, signed by qualified appraiser completing a qualified appraisal attached to Form 1040

Case Study 2: A Texas Ranch and a Retained Life Estate

Retained Life Estate Agreement

Key components, consistent with state law:

- Ongoing tenant responsibilities: property taxes, utilities, insurance, repairs and maintenance
- Capital improvements
  - ✓ Actuarial formula is best
  - ✓ Who authorizes improvements?
- No waste
- Access for visits/right of entry
- Use issues, including whether renting is allowed

Case Study 2: A Texas Ranch and a Retained Life Estate

Key components (cont.)

- No encumbrances/mortgages
- Dealing with incapacity
  - ✓ Durable power of attorney is advisable
- Dealing with vacancy
  - ✓ Rights of entry and right to correct/pay
  - ✓ Options:
    - Tenant donates remaining interest (deductible)
    - Lease the property
    - Cooperation in selling the property

Case Study 2: A Texas Ranch and a Retained Life Estate

Conservation or preservation easement

- Should be conveyed prior to conveying remainder interest
- Generates a separate tax deduction

Making a partial cash payment for the remainder interest

- A bargain sale
- Requires liquidity on part of charity

Case Study 2: A Texas Ranch and a Retained Life Estate

Comparing a bequest of property with a lifetime gift subject to a retained life estate

	Bequest	Retained Life Estate
Continued use of property	Yes	Yes
Continued responsibility for taxes, repairs, etc	Yes	Yes
Removal of asset from taxable estate	Yes	Yes
Charitable income tax deduction	No	Yes
Recognized now for generous gift?	No	Yes
Asset avoids probate process	No	Yes
Decision is	Revocable	Irrevocable

Case Study 2: A Texas Ranch and a Retained Life Estate

What to do when you learn of a bequest intention likely involving a residence or a farm/ranch?

- *Visit them next week!*
- Assume they have not been introduced to the retained life estate concept by their advisors

Leadership Gifts

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

-- John Brown

Case Study 2: A Texas Ranch and a Retained Life Estate

Retained Life Estate arrangements should be entered into very carefully

- It's a long-term relationship to be entered into with care and commitment by the parties.
- Approach the due diligence as if it's an immediate outright gift.
- Some motivated donors may need to be talked <u>out of</u> doing a retained life estate if they don't have sufficient other assets.

Case Study 2: A Texas Ranch and a Retained Life Estate

National Wildlife Federation (NWF) and the Jacksons' Texas Ranch

- The Jacksons, long-time NWF members and San Antonio residents, enjoyed their ranch in the country as a base for birding outings.
- They had no children, and had wanted to leave their ranch through their wills to NWF.
- They became aware of the option of deeding over the property now, but retaining the right to use it for the rest of their lives.
- The Jacksons had leased their mineral rights to an exploration company.
- They wanted to generate current tax deductions.

Case Study 2: A Texas Ranch and a Retained Life Estate

National Wildlife Federation and the Jacksons' Texas Ranch

- The Jacksons approached NWF about the retained life estate alternative.
- NWF was interested, provided the mineral rights (subject to lease) would be included in the conveyance (to assure deductibility of the gift.)
- Due diligence: Title search, environmental assessment, consultation with local brokers, review of the mineral lease -- all revealed no challenges.
- A gift acceptance letter was agreed to by the parties.
- The Jacksons and NWF worked out a life estate agreement detailing the responsibilities of the parties.

Case Study 2: A Texas Ranch and a Retained Life Estate

National Wildlife Federation and the Jacksons' Texas Ranch

- The Jacksons obtained a qualified appraisal.
- NWF and the Jacksons' advisors estimated the tax deduction that would be generated by the gift.
  - ✓ The Jacksons decided to gift 50% of the property immediately, while agreeing to gift the balance at a later date – in order to increase their chances of using all of the available deductions over as much as twelve years.
- The property was deeded over, and the life estate agreement was signed.
- An "agreement to convey" was also executed, assuring that NWF would wind up with 100% of the property one way or the other.

Case Study 2: A Texas Ranch and a Retained Life Estate

National Wildlife Federation and the Jacksons' Texas Ranch

Benefits for the Donors

- The Jacksons continued to use the property as they had before, and retained full responsibility for taxes, maintenance, utilities, etc.
- They continued to receive mineral lease royalty payments.
- They triggered charitable tax deductions they would use for many years ahead.
- They had the satisfaction of being recognized for a generous gift in their lifetime.

Case Study 2: A Texas Ranch and a Retained Life Estate

National Wildlife Federation and the Jacksons' Texas Ranch

<u>Benefits for NWF</u>

- Unlike a bequest intention, which is subject to revocation, the gift was completed here and now.
- NWF could count on proceeds from sale of the property at some point in the future.
- NWF was able to publicize this gift – inspiring other property owners to inquire about retained life estate gifts.
- Mr. Jackson died last year. The property is now being marketed.

Emerging Best Practices: Policies and Procedures

Real Estate Gift Acceptance Policies and Procedures

- Process of review/revision with key staff and board assures buy-in and all key players on the same page.
- Develop a streamlined approach to the “who does what” of real estate gifts.
- Emphasize “user-friendly” approaches.
- Apply a real estate gift minimum on a net present value basis.
- Include as much of the full menu of gift structure options as possible, with clarity about conditions on each.

Emerging Best Practices: Marketing, and Initiating the Conversation

They're not going to call you without some prompting…

- Emphasize problem solving, understanding of the prospect's situation.

- Repeat the message in many forums – newsletter, annual report, emails, website, social media, etc.

- Case studies, especially real ones, are most effective.

- A prompt, user-friendly response when the call comes in is critical.

Emerging Best Practices: Marketing, and Initiating the Conversation

Better yet, don't wait for the call. Initiate the conversation.

- Make the right real estate gifts happen.
- Convene a small group to brainstorm donors and friends who fit the profile of a potential real estate donor.
- Do your research.
- Figure out who can best have the real estate conversation.
- Recognize that your prospect may very well welcome a conversation about the real estate issues facing them in the years (or months) ahead.

Emerging Best Practices: Marketing, and Initiating the Conversation

Initiating the real estate conversation

Emerging Best Practices: Risk Management through Screening and Due Diligence

There are proven ways to identify and manage the risks of real estate gifts.

- Environmental risk is often exaggerated, based on ill-advised acceptance of a bad real estate gift years ago.
  - Phase I environmental assessments are readily available and reliable.
  - The trend is for the donee institution to pay for such assessments, as cost of doing business.
- Liquidity and holding cost risks are real but manageable
  - Structuring alternatives such as options, simultaneous closings, etc. are available while avoiding "pre-arranged sale."
- Intelligent screening and rigorous due diligence: a two-step process makes sense.

Emerging Best Practices: Risk Management through Screening and Due Diligence

A donor-friendly two-step process works well:

- An initial go-no go based on preliminary inquiries and the information that can often be gathered in a 30-minute phone call:
  - If there is a preliminary go-ahead and the donor appears committed, then proceed with the expenses of due diligence
  - If the initial answer is no, then the donor isn't kept hanging, and the non-profit can quickly move on to more promising gift prospects

- If due diligence checks out, and all criteria are met, then final gift approval leads to gift closing

Emerging Best Practices: Risk Management through Screening and Due Diligence

Critical Information for the Initial Assessment (the 30-minute call)

- ✓ Property location and description
- ✓ Land and building area
- ✓ Current uses
- ✓ Abutting uses
- ✓ Any environmental issues
- ✓ Estimated value
- ✓ Recently listed?
- ✓ Potential buyers?

- ✓ Zoning
- ✓ Donor info.
  - ages, ownership form
- ✓ Mortgage?
- ✓ Cost basis, roughly?
- ✓ Donor objectives
- ✓ Gift vehicle contemplated
- ✓ Purpose of gift

Final Thoughts

- Real estate is the largest component of the intergenerational wealth transfer that surrounds us, and much of this real estate wealth is in vacation/second homes.
- Why should New York and Washington DC-based charities be harvesting real estate gifts in New Mexico? Local non-profits have a lot to gain by getting in to the game.
- It’s not rocket science – common sense best practices for real estate gifts are increasingly being adopted.
  - Including how to screen out the bad gifts and focus on the good ones.
- Don’t get caught in the chicken and egg syndrome. Just get started with initial steps in developing the capacity to attract and close the right real estate gifts.

Questions?

Dennis Bidwell
Bidwell Advisors
dbidwell@bidwelladvisors.com
www.bidwelladvisors.com
(413) 584-2732

Elizabeth Roghair. CPA
Gift Planning Coach for
Individuals and Organizations
eroghair@northwestern.edu
(505) 466-4405