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ON FAMILY OFFICE MANAGEMENT

How multi-generational real estate families can navigate complexity

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Families that operate real estate businesses deal with a lot of complexity due to the combination of both business affairs and family dynamics.

That encompasses:

- **External business matters (beyond their control):** geopolitical, economic, supply-demand of inventory, environmental, land use, regulatory, financing, banking, valuation, (re)financing, interest rates, pandemic impacts, etc.
- **Internal business matters (usually within their control):** overall real estate acumen, specific real estate segment expertise, narrow or vast firm segmentation (i.e., commercial, office, industrial, retail, multifamily, residential, mixed-use, etc.) and vertical integration (i.e., research and due diligence, acquisition, sale, development, property management, leasing, etc.).
- **Family matters (some of which are beyond and/or some of which are within their control):** tax planning and execution, entity ownership and wealth transfer optimization, wealth and investment management, human capital leadership, management and operations.

Some real estate families are energized by this complexity, viewing it as a Rubik's Cube to solve; while other real estate families become overwhelmed and paralyzed by this complexity, viewing it as an albatross around their necks.

Regardless of the real estate family's view, family members, principals, their family offices and their family enterprises all need to plan and prepare for continuity, whether in the form of succession transition or an enterprisewide sale to become a "liquid family" — as there is tremendous opportunity for generational wealth creation and transfer, and management. Governance is critical to achieving durable family harmony and financial prosperity by aligning the family with the operations and with the family office.

WHY NOW?

Succession, transition and the rising generation are here. "An estimated $100 trillion is currently being transferred from the baby boomers to their heirs and charities. … Over the next 25 years, the world is set to become an 'inheritocracy,' " according to the Financial Times. Baby boomers account for over 44% of real estate wealth in the U.S., according to the Federal Reserve (data as of February 2024). As such, boomers are actively transferring assets through trusts, real estate, gifts, wills and other methods.

Are principals/family members, family offices and family enterprises ready?

Administrative and operational excellence, financial reporting and accounting are mission-critical. The unglamorous and painful work of getting organized to gain clarity around real estate portfolios and properties, entity structures and ownership, as well as compliance and tax, are paramount to maximizing generational wealth transfer, philanthropic planning and legacy. On top of this, anti-money laundering (AML) and know-your-client (KYC) compliance, regulatory and legislative requirements focused on transparency, reporting and disclosure are on the rise. The Corporate Transparency Act (CTA) is a prime example of this trend.

THINGS TO WATCH FOR

- There are recurring issues and challenges endemic to real estate principals, family offices and family enterprises. Jeri Frank, co-founder and CEO of Stratafolio, shared her observations from her real estate clients:
- Inability to see the full picture of assets owned. Even the principals or family office at the top of the ownership structure do not have a thorough understanding of equitable and beneficial ownership and effective ownership.
- Unclear debt and guaranty exposure due to multiple lenders, varied terms, varied borrowing base calculations, varied covenants and varied maturity dates, etc., of multiple credit facilities and their numerous amendments.
- Poorly tracked records, making it unclear when leases were signed, escalations began or any side agreements were made — making it difficult to manage the tenant relationship when the tenant may be in default or the owner is incapacitated, loses interest or ages out.
- Poor management of lease escalation clauses and common-area maintenance, resulting in years of undercollection of rent and increasing operating costs.
- Lack of tracking of tenant certificates of insurance, resulting in some tenants not carrying the insurance required as part of the lease — and resulting in organizational financial and legal risk exposure.

ROAD MAP FOR REAL ESTATE SUCCESSION AND TRANSITION

Jeff Gould, a principal and founder of Lineage Asset Advisors, is on the front lines with his clients for real estate advisory services. First-generation families, principals and real estate owners often have different perspectives on their portfolios compared to the rising next generation. As a result, the first generation's legacy may not always endure after they have passed.

"Each family member plays a unique role in contributing to the family legacy. … Every family has a strong team of estate planning advisers that help families plan for future generations," Gould states. "Without proper planning, real estate assets can become a source of conflict and confusion, leading to costly legal battles, family disputes,and even the dissolution of a business. Failing to plan for the transition of real estate assets can leave the assets vulnerable to many management risks and external risks."

Continuity in the form of succession transition or enterprise sale to become a "liquid family" is a complex process, requiring deep alignment and communication beyond the portfolio. Family dynamics, governance, shared-asset planning, estate planning, tax planning, financial planning and risk management — they all play a role. When there is misalignment with real estate, a lack of planning can rupture a family and lead to conflict and even legal disputes.

To mitigate challenges and avoid conflict, Gould recommends developing a real estate road map:

Phase 1: Discovery

In the Discovery phase, the family and their advisers perform due diligence on all aspects of their existing real estate portfolio, as if they are acquiring the portfolio for the first time. For some, this is a process of rediscovery.

Key elements of a real estate portfolio assessment include:

- Financial performance
- Current and future market valuation
- Debt analysis
- Tenant and lease analysis
- Market analysis
- Portfolio composition analysis
- Property condition assessment
- Property and asset management performance
- Risk analysis (i.e., cash flow, debt, tenancy, market factors, taxes, regulatory, etc.)
- SWOT analysis (strengths, weaknesses, opportunities and threats)
- Ownership structures and dynamics
- Title

Phase 2: Planning

During the Planning phase, the family takes the findings uncovered during the Discovery phase and develops a business plan. In addition, the family can consider methods to mitigate portfolio risks, address financing, plan for lease expirations and tenancy issues, and implement tax-advantaged strategies. The business plan covers everything from family governance to communication and should include a shared-asset plan, which outlines how real estate assets will be shared and establishes the structure for how the family will manage them. Once the family understands the performance and makeup of their real estate portfolios and has a business plan in place, the next step is to name trusts/ trustees and accomplish estate and tax planning.

Phase 3: Implementation

Implementation is the culmination of the Discovery and Planning phases. Once the plans are in place and the stakeholders aligned, the next focus is on bringing everything to life. Below are examples of key areas in the Implementation phase:

- Property and asset management integration
- Portfolio diversification
- Capital improvement projects
- Selecting the right fiduciary
- Title considerations
- Hold vs. sell decisions

RECOMMENDATIONS AND ACTIONABLE STEPS

- Work with principals/family members, the family office and the family enterprise's internal teams from operations, legal, compliance, tax, accounting, finance, technology, marketing and other relevant areas; review and evaluate risks and opportunities, as well as other concerns; establish, refine, and review systems, policies, and procedures, as well as determine accountability with KPIs across the family office and family enterprise.
- Evaluate and address compliance and regulation requirements (i.e., AML, KYC, etc.) and stay updated on existing and new legislation and regulatory changes.
- Complete an audit of all entities and the associated properties, insurance, loans, tenants, deeds and financials to start tackling the gaps.
- Have a consolidated view of all real estate owned (by date, entity, percentage and type of ownership interest) for a single source of truth.
- Create visibility and assign responsibility to communicate at a specific cadence to principals and family members so they can know and track their real estate ownership, valuations, performance, cash flow, etc.
- Curate, develop, implement and continually refine the technology stack (e.g., accounting/finance, performance reporting, etc.).

FINAL THOUGHTS

Governance and continuity planning is crucial for real estate families, their family enterprises and family offices. Thoughtful planning can help ensure the long-term success of the real estate portfolio(s) and the family's legacy.

This article is not intended to provide legal advice but to provide general information and discussion on current events and possible solutions. You should seek your own legal advice and other professional counsel regarding your specific needs, situation and circumstances.