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Family Property Raises the Question of Managing for a Legacy

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SOME wealthy people will have to make a decision soon if they are to take advantage of the $5.12 million gift tax exemption that is due to expire at the end of the year.

How have you dealt with gifts to your heirs? Have you figured out a way to divide your property so that all your heirs feel they were fairly treated?

Cash is always the easiest way to take advantage of the exemption, but few wealthy people want to give that much money away lest they need it at some point. Property, on the other hand, has several virtues. Its value may be depressed now, but it is likely to go up by the time heirs get control. In addition, some wealthy people view property as a way of keeping the family together.

But giving a second home as a gift can be more complicated than people often expect, wealth advisers say. Other types of property, like timberland, farms or buildings, are a better option, advisers say, because they generate income. Still, they also present an intriguing problem beyond how to take advantage of the tax break: how do you make sure the property is well managed for the next 50 years?

This is something the family that Mark Schleicher married into has been contemplating for 90 years. He said that his wife's family acquired 33,000 acres in southwest Florida when they lent a timber baron some money and he defaulted on the loan. The land, on the border of Sarasota and Manatee Counties, was held in trust and more or less sat there.

The family, whose money came from the Joseph Schlitz Brewing Company, had hired a manager to operate it as a ranch, mostly for running cattle, growing citrus trees and mining shells, which were used for road construction.

But in the 1990s, the family decided that the land was being mismanaged and sought advice on how to develop it, Mr. Schleicher said. Since then, they have turned a quarter of the land into Lakewood Ranch, a planned community with 7,500 homes, four million square feet of commercial space and amenities that include golf courses, soccer fields and a polo field.

"We're taking great pride in doing this project," said Mr. Schleicher, who is a board member of Schroeder-Manatee Ranch or SMR, the family holding company that owns Lakewood Ranch and other businesses on the property. "It's not about squeezing the last nickel out of the thing. It's

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Northern Trust

about creating a really first-class community that we can all be proud of, and it's our legacy, really, as a family."

This, of course, is the reason people leave property in trust. Cash can be spent and so can stocks and bonds, after they are cashed in. But land is meant to keep everyone together generation after generation. So why, then, do these plans often fail?

Not surprisingly, many of them are hatched too quickly or without any advice from the people who are going to benefit from the property but also have to manage it.

"When parents don't communicate well, that's when things don't work out," said Peter E. Lang, a managing director at HighTower Advisors, a wealth management firm. "The more complicated the asset, the more planning; that's when you need to get the kids involved."

This particularly applies to property, whether it is a vacation home, undeveloped land or a vast planned community. It comes with the obligation to manage it, whether providing simple upkeep or making larger economic decisions.

Scott J. Cooper, managing director in the wealth structuring group at Merrill Lynch, said there had been a lot of interest in putting vacation homes in trust to take advantage of the gift tax exemption, but he said homes were not always an ideal asset, particularly when several children and spouses would use one house.

"Anyone who has ever shared a dorm room with another person probably has a point of view on this," he said. "First of all, there is the issue of, do the kids really want it? Then, you have all the challenges of a time share. When it's time to remodel the kitchen, do you go with granite countertops or Formica? That gets pretty dicey."

Mr. Lang said that even when clients navigated these issues smoothly, there was usually compromise.

He recalled a client who left her Cape Cod beach house to her twin daughters. One lived around Boston and used it all the time; the other lived outside New York and had little interest in making the five-hour drive. But they agreed to own it jointly and split the expenses because the New York daughter worked in the family business and benefited from that in a way her sister could not.

"They were just very open about it," Mr. Lang said.

With a property like Lakewood Ranch, which generates income but also requires investment to keep building it out, the intrafamily discussions are bigger and carry greater financial consequences.

"Real estate is very personal," said Michael E. Papierski, senior vice president at Northern Trust and a board member of SMR. "People don't look at it anything like stocks and bonds. They look at how it's going to be managed in the future."

His firm manages various properties owned in trust, including a ski resort, a Manhattan office building and a recreational complex in Michigan. He said a big issue that divided families was whether the property should be run to generate income in the short term for current beneficiaries or managed so that its value increased over time.

The answer usually depends on what kind of beneficiaries they are. A second spouse who receives only the income from a trust is not going to feel the same about managing the property as children from the first marriage who will pass it on to their children.

In the case of Lakewood Ranch, Mr. Schleicher said the families used a combination of cash flow and borrowing to build out the community. Doing so required agreement not just among the 12 board members but also among the larger family.

“The family generally has a unified opinion that this is a legacy asset,” Mr. Papierski said. “They see the long-term benefits and value that can come from this property.”

But that also raises the question of what happens when the number of descendants increases over time and there are more, but smaller, ownership stakes. Mr. Schleicher said that two or three families controlled Lakewood Ranch and that he had involved his children so they would know what was going on when their generation took over.

This is not the norm. Mr. Papierski said Northern Trust used to manage an office building that was owned in trust with 25 beneficiaries who often disagreed. In that case, he said the beneficiaries got lucky: they were able to sell the building back to the developer, allowing the trust to simply distribute cash to the beneficiaries.

More often, family members will struggle to sell their stakes in a property. Mr. Cooper at Merrill Lynch said he advised clients to put provisions in trusts so that children could sell their shares to other family members.

“The trust also needs the mechanism to buy a beneficiary’s interest out, if everyone has a different position in life and there’s a disparity in income,” he said. The rich brother, he said, “should be able to find a way to buy out his brothers’ interest.”

“But it’s hard to force people to do it,” he said.

On an income-generating property, Mr. Cooper said, the same issues can arise when siblings or cousins are seeking money from the trust. “I don’t care who you are, if your brother is getting a $25,000 distribution because there was some excess cash in the building, everyone wants a $25,000 cash distribution,” he said.

When it works out well, though, property can indeed keep a family together. Mr. Schleicher said he thought the family had succeeded in sticking together because no one depended on the income from the property.

“It sat there for 70 years,” he said. “There wasn’t any income there. So this is kind of like a newfound income stream, if you will.”

In the 10 years that he has been involved in managing the property, he said the family had gotten along. “We’re all in the same boat and pulling in the same direction,” he said.

But he said it would take an additional 30 or 40 years for Lakewood Ranch to be completed. And that’s a long time for any boat to stay the course — something for others to keep in mind.