CHASE

Real estate succession planning

Building a business and wealth for the next generation

What has the potential to derail the generational handoff of your family real estate business? Procrastination. When families struggle with a portfolio handoff, it's often because they waited too long to tackle key questions and create a succession plan.

"You can't do it early enough," said David Diggs, Senior Regional Sales Manager at Chase. About 1 in 4 U.S. family business leaders surveyed in Deloitte Private's 2024 Family Enterprise Survey strongly agreed they have a succession plan that would let their business run smoothly and without interruption following an important family employee's departure. But only 13% of next-generation family business members felt the same.

Here's the good news: You don't have to have every succession-planning decision made to get started, said Steven Faulkner, Managing Director and Head of Private Business Advisory at J.P. Morgan Private Bank.

"If you try to solve for 100% and plan for everything, you'll never get there. But if you shoot for 80%, keeping in mind that 20% of what you're planning for may change, you can move the needle significantly," Faulkner said. "It's doing the best you can with the information you have and adjusting as needed."

Portion of family business leaders who agree they have a succession plan in place that would let their business run smoothly following the departure of an important family employee:

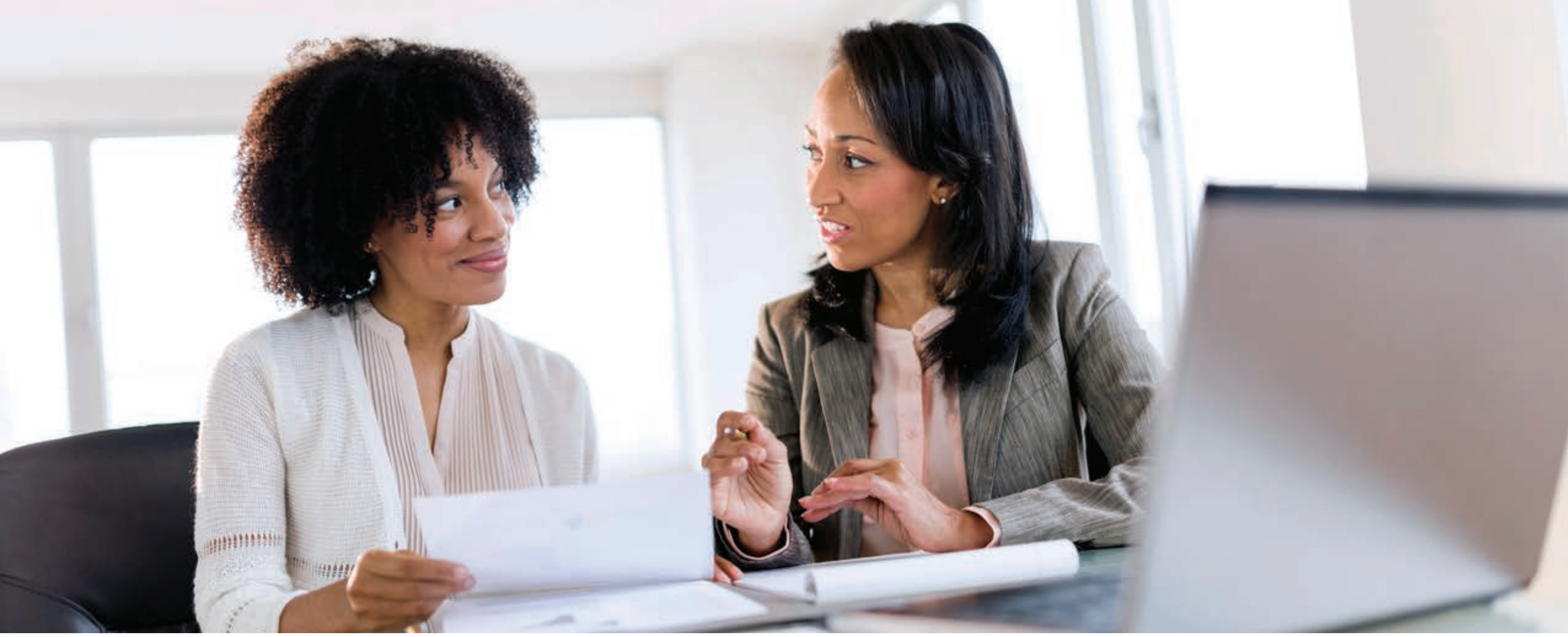
24% current generation

13% next generation

Source: 2024 Family Enterprise Planning, Deloitte Private

We'll walk you through best practices that can help you tackle the most common sticking points and develop a succession plan for your real estate business:

- Preparing next-generation family leaders for success
- Communicating effectively and preventing family conflict
- Tax planning considerations
- Making your portfolio resilient enough to thrive into the next generation



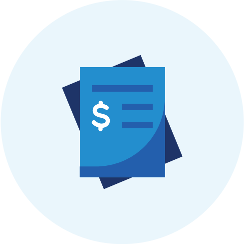
Discuss plans and align on goals

First, craft a vision of your family real estate business. Do you see one of your children or another family member leading the business one day?

If so, make sure that desire is mutual. While only 8% of current U.S. family business leaders expect successors to sell part or all of their interest in the business, 18% of next-generation family business members expect to sell, according to Deloitte Private's 2024 Family Enterprise Survey.

Have regular one-on-one conversations with your potential successors to discuss their aspirations and their vision for the future of the business, Faulkner said. Are their goals aligned with yours and those of other family members?

Those conversations will guide the succession-planning process for your real estate business, whether that means involving the next generation in operations or exploring other options, from hiring outside management to realizing growth by selling your portfolio.



8%

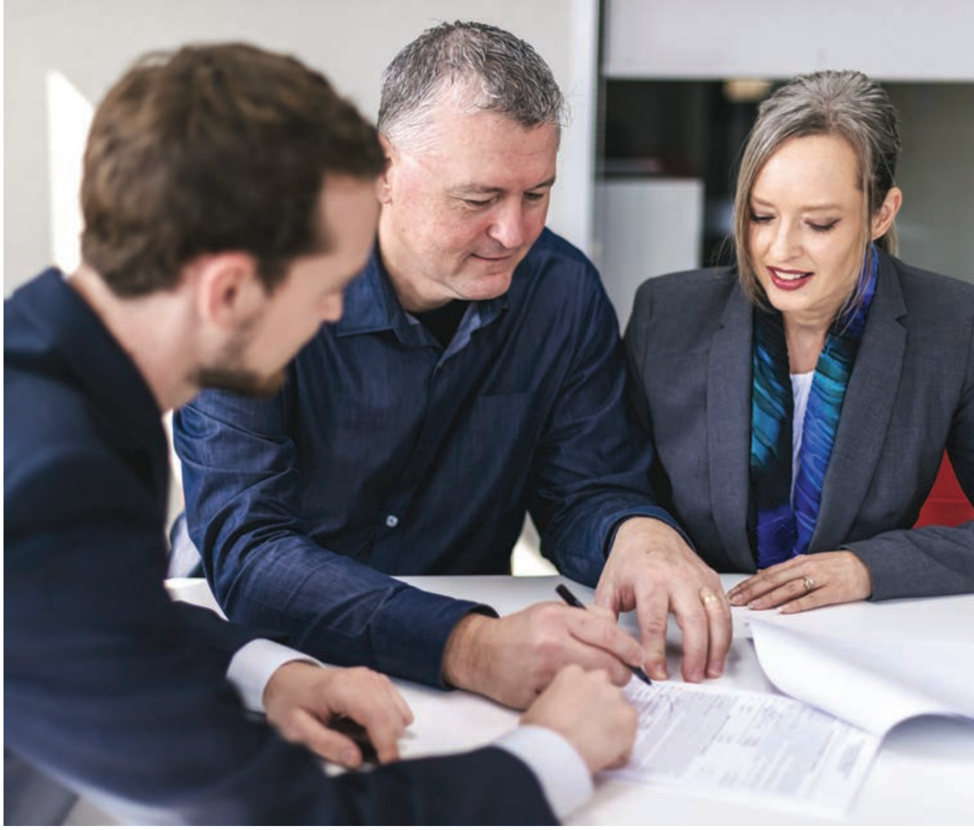
of current family business leaders expect their successors to sell part or all their interests

18%

of next-generation leaders expect to sell all or part of their interests

Source: 2024 Family Enterprise Planning, Deloitte Private

Make contingency plans for sudden transitions



No one expects a sudden event like a critical medical issue to force a change in their family business's leadership before everyone is ready. But too often, real estate investors and their families fail to plan for that transition until they're forced to, Faulkner said.

It can be devastating for the business and the family when members have to step in without the necessary training or access to key information and records. Develop contingency plans for a sudden management change just as you'd plan for other catastrophic events, Faulkner said.

That plan could include:

- A clear vision for the company's future to guide new leaders
- A list of key players and their roles and responsibilities
- A structure to connect business leaders and family members with a stake in the business
- A way family members can exit ownership of the business without jeopardizing its future
- Regular reviews to update the plan as business or family circumstances change

Even if a family's real estate business relies on a property management company to handle day-to-day responsibilities, family members still need to make plans for handling strategic decisions, Faulkner said. For instance, who has the ability to buy and sell properties, take on a new multifamily loan, refinance debt, or decide whether to distribute cash flow or reinvest it in the business?

If families don't answer enough of those questions in advance, they may need time to get their affairs in order before they can make changes to commercial real estate loans or operating accounts following a transition, Diggs said.

"But when families put a plan in place—all the documentation is buttoned up, they've got the new operating structure and know who's signing all the documents—it can be seamless," he said.

Adopting digital banking platforms can help make transitions smoother by centralizing the family real estate business's operating accounts and streamlining processes for sending payments and receiving rent. Digital tools can also save time and make it easier for successors to understand and follow existing processes.

Our team can help you find the right digital banking and payments tools for your business.
Learn more

Map out orderly transitions

A well-planned handoff to a chosen successor should incorporate all the elements of a plan for an unexpected transition, plus training the next generation of leaders and integrating them into the family real estate business, Faulkner said.

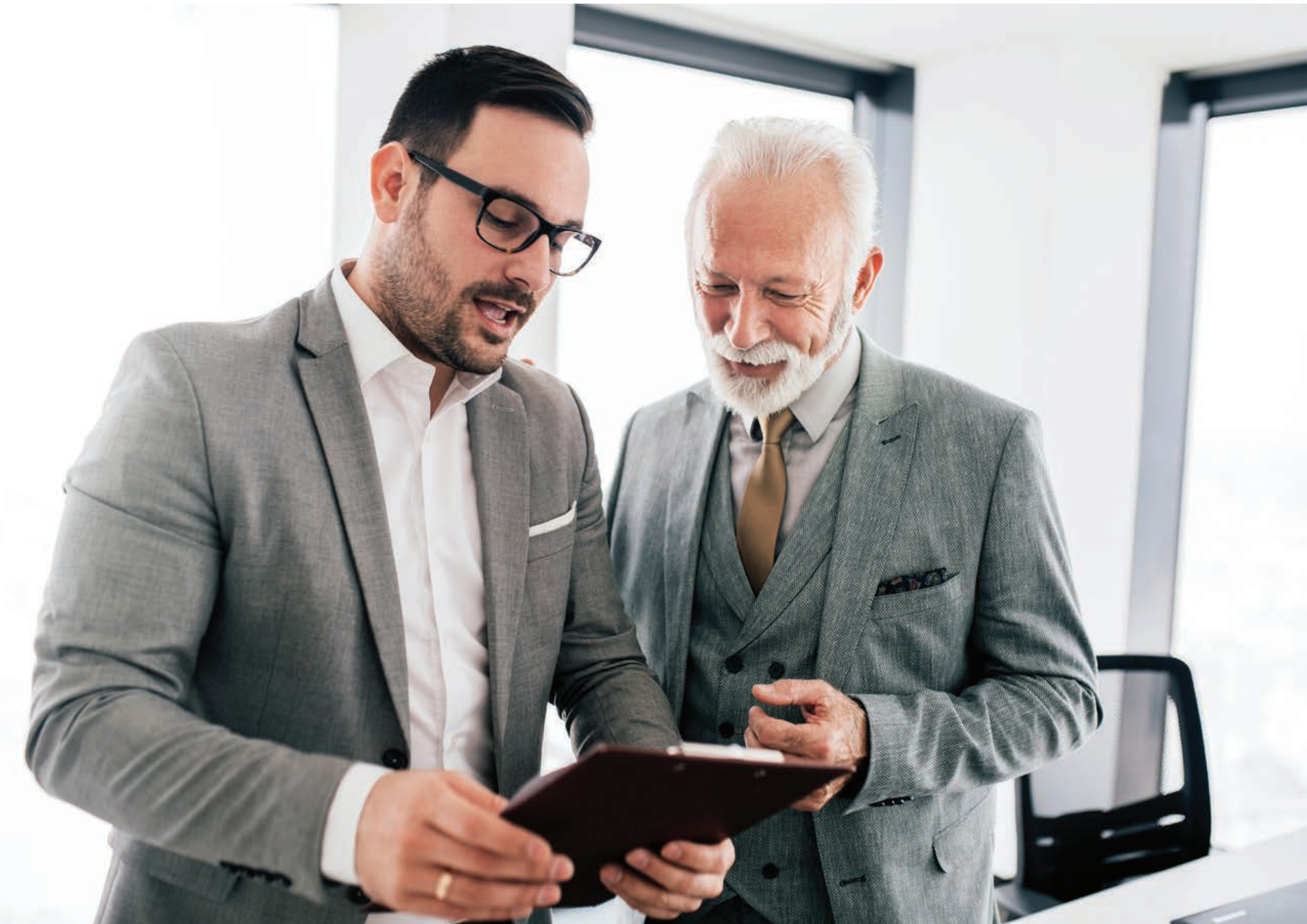
If you're interested in having your children join the business, consider what you want their journey to look like. Some questions to consider:

- Should they have certain educational qualifications?
- Should they gain outside industry experience or start their careers in the family business?
- Do they need to start in an entry-level role and work their way up?

For the sake of family harmony, expectations should be clear, and any rules should apply universally, he said.

Some family businesses rotate members of the next generation from role to role so they're exposed to all aspects of operations, but future leaders also need a chance to develop expertise and a track record of success. As they gain experience, they should also gain responsibility—and be allowed to stumble a little on the way.

"You want to give them the opportunity to make mistakes in a contained way, so there's a learning process that allows you to observe, mentor and teach," Faulkner said.



Gather the right team and planning documents

Creating a real estate succession plan is a team sport. Consider involving your attorneys, accountants, financial advisors and property manager, if you use one, Diggs said. If you have major investment partners, they should be part of the conversation, too.

"Depending on how you've structured your operating agreement, they may have a say in any changes to management or ownership structure, but even if they don't, you want them to be comfortable with the plan," he said.

Those partners can help you prepare key succession planning documents. Keep in mind your family real estate business might not require all these documents or you might need others that are not listed.

Here's a checklist of documents to gather to get you started:

- ☐ Operating, governing and/or partnership agreements, including buy-sell agreements
- ☐ Employment agreements
- ☐ Will
- ☐ Revocable and/or irrevocable trusts
- ☐ Other trusts of which family members are grantors, trustees or beneficiaries
- ☐ Beneficiary designations on deferred income assets
- ☐ Property and casualty insurance policies
- ☐ Life insurance policies
- ☐ Family tree
- ☐ Healthcare proxy
- ☐ Living will
- ☐ HIPAA form
- ☐ Powers of attorney
- ☐ Deeds or titles
- ☐ Loan documents
- ☐ Capitalization table
- ☐ Appraisals

Make time for tax and estate planning

Family multifamily real estate businesses can be transferred from one generation to the next, especially if you start both tax and succession planning early.

The U.S. tax code provides opportunities to defer taxable gains on real estate investments, leaving more assets for your family or for reinvestment in the business, Faulkner said.

But some strategies that can help you accomplish your goals for your business and family are more effective if you lay the groundwork before you're ready to pass the torch to successors, said Andrew Bonnington, Wealth Advisor at J.P. Morgan Private Bank. Tax planning can be particularly critical if the value of your real estate portfolio one day rises to a level substantial enough to incur estate taxes.

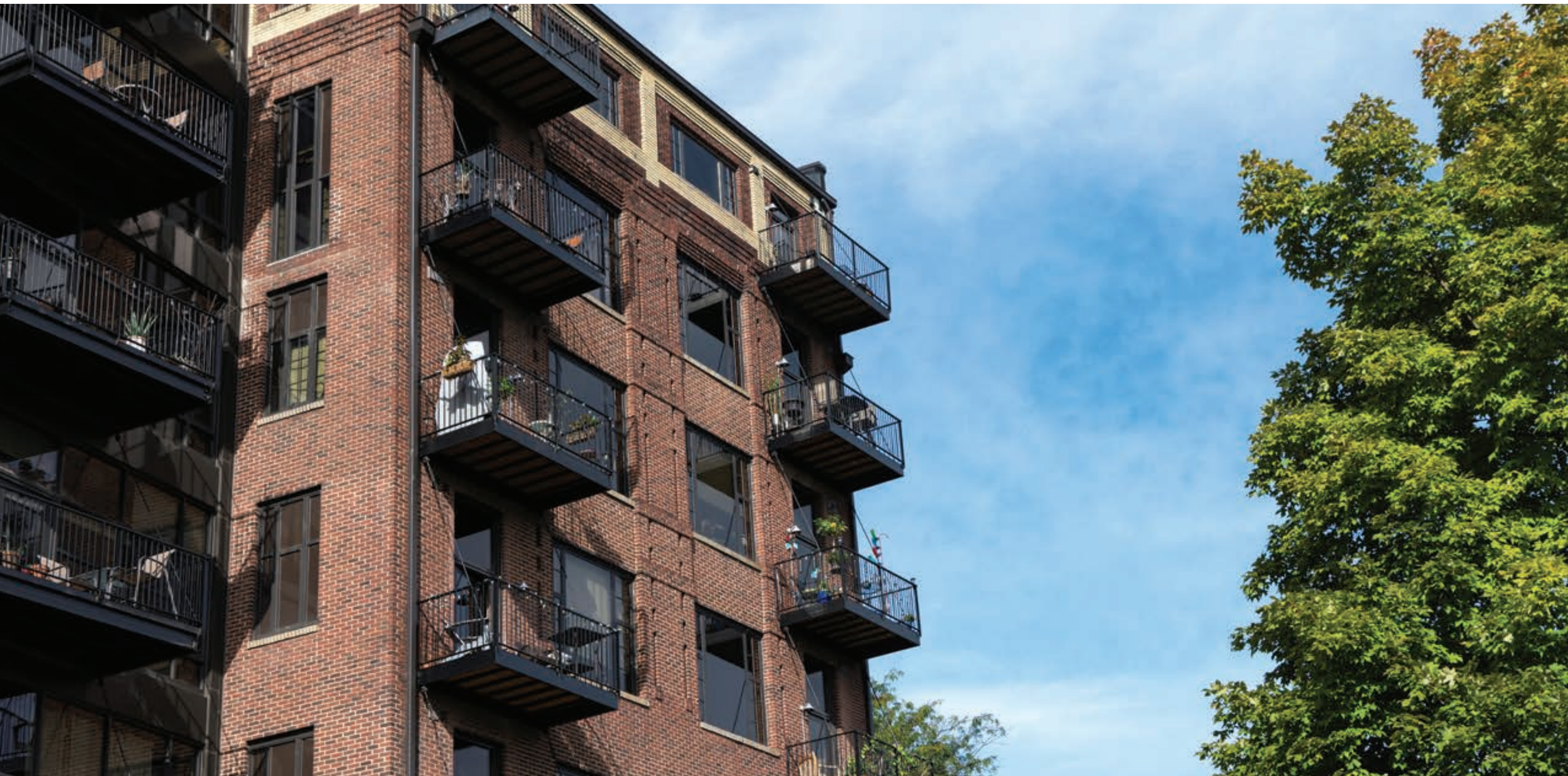
Each family and business has different needs, and federal and state estate tax laws are complex. So it's important to work with your legal, tax and financial advisors to figure out what's best for you.

And while taxes should be part of your estate and succession-planning process, they shouldn't drive the process, Bonnington said.

> **"The most important thing is to think about your intentions. What are your goals, and what do you want to accomplish with what you're giving to the next generation?"**
>
> **Andrew Bonnington**
> Wealth Advisor
> J.P. Morgan Private Bank

"The most important thing is to think about your intentions. What are your goals, and what do you want to accomplish with what you're giving to the next generation?" he said.

If you rush to implement a plan before you're ready, some actions may be difficult to undo. Work with your financial advisors to understand the full implications of any steps you're considering and how they will affect who holds control and decision-making authority for the business, as well as your and your family's finances, Bonnington said.

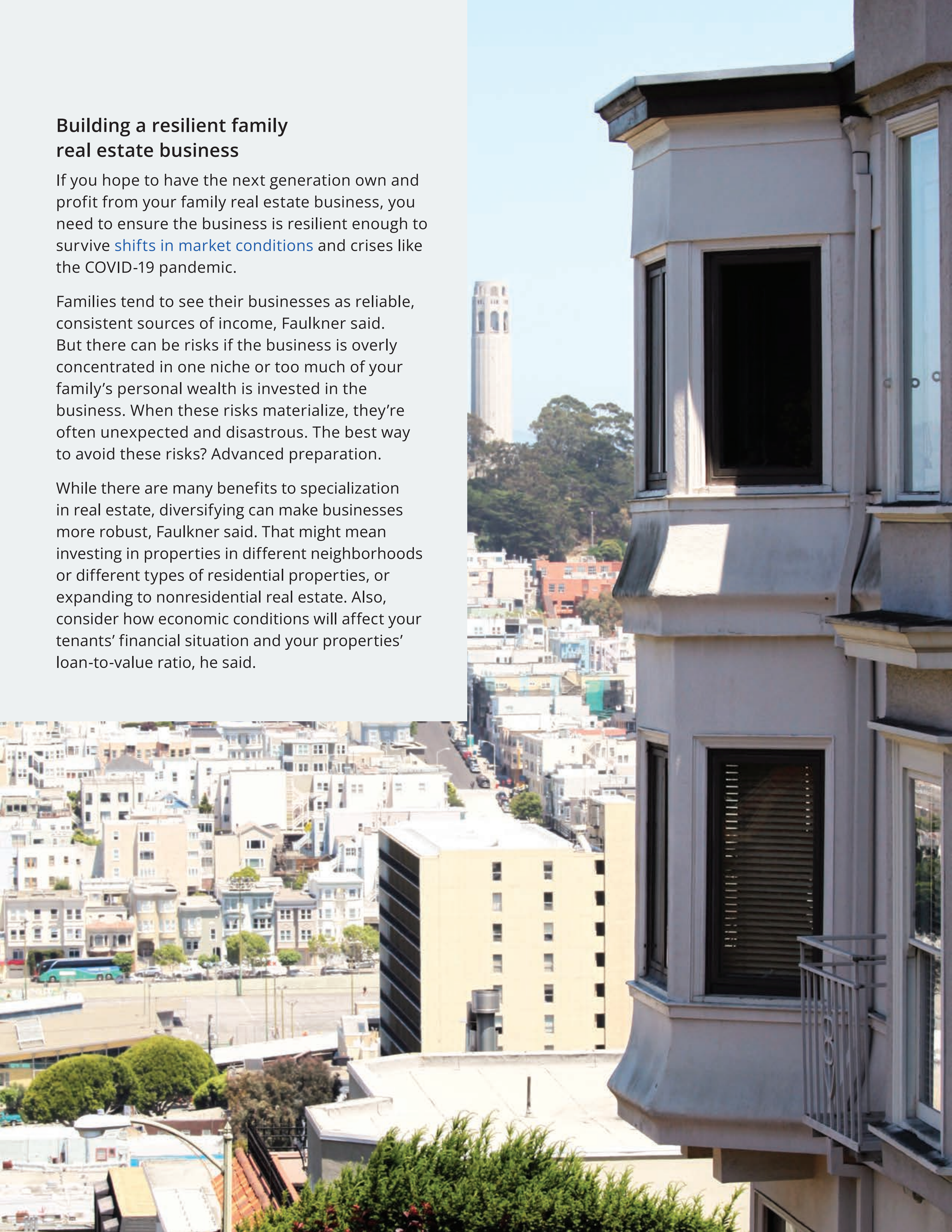


Building a resilient family real estate business

If you hope to have the next generation own and profit from your family real estate business, you need to ensure the business is resilient enough to survive shifts in market conditions and crises like the COVID-19 pandemic.

Families tend to see their businesses as reliable, consistent sources of income, Faulkner said. But there can be risks if the business is overly concentrated in one niche or too much of your family's personal wealth is invested in the business. When these risks materialize, they're often unexpected and disastrous. The best way to avoid these risks? Advanced preparation.

While there are many benefits to specialization in real estate, diversifying can make businesses more robust, Faulkner said. That might mean investing in properties in different neighborhoods or different types of residential properties, or expanding to nonresidential real estate. Also, consider how economic conditions will affect your tenants' financial situation and your properties' loan-to-value ratio, he said.



Preventing family discord

Family conflict can lead to as much turmoil as traditional business challenges. Successful multigenerational businesses prevent disputes by proactively addressing common sources of conflict, Faulkner said, including:

1. **Distribution policies:** Clear, transparent policies governing how the family real estate business distributes income can help prevent disputes over how much should be returned to shareholders versus reinvested in the business. Make sure those policies provide flexibility for retaining cash that will help the business grow—and for limiting distributions when times are tough.

2. **Control:** Think about whether family members in future generations who aren't active in the business should have an ownership interest. Family real estate businesses tend to be more successful when ownership interests, especially all voting interests, are held only by family members actively working in the business, Faulkner said. This will also impact investment decisions around which properties to hold, sell and acquire. It can also help establish an appropriate leverage structure to use when making an acquisition.

   If several people are interested in running the family business, it might be tempting to split your real estate portfolio to give each the chance run an independent business, rather than giving each a share of a unified business.

   Faulkner warned this approach can lead to family conflict. You might be able to split your portfolio into sets of properties with equal values today, but properties' values frequently shift based on type, geography and differing levels of leverage. You could leave one child with a slice of the business worth significantly more than their sibling's share. Once such a plan is in place, it's very difficult to reverse.

3. **Compensation and advancement:** Think about what qualifications family members need to hold before entering the business and develop a plan for handling hiring, promotion and compensation decisions. Policies should be transparent so family members—those active in the business and not—understand what's expected. And they should be applied consistently, Faulkner said.

   Consider creating an independent committee or board to weigh in on family employees' advancement and compensation. Be aware that compensation policy and distribution policy often have an inverse relationship: When more compensation goes to people actively involved in the business, there's less available to distribute to owners.

4. **Opportunities to exit the family real estate business:** You don't want one family member's desire to leave the business to threaten its future, or your family's. Faulkner recommended crafting a buy-sell agreement: a legally binding contract that establishes what happens to a partner's share of the business should they exit, either by choice or incapacity.

   Determine how you will assess the value of the business when a family member exits, how you'll finance buyouts for departing family members and how much consensus should be required if the family were to sell the entire business. Don't forget the valuation's tax impacts.

   Managing family dynamics might require tough conversations, but transparency and communication are vitally important. Share your vision for the business's future and the reasoning behind decisions. That step is particularly important if you anticipate certain family members will disagree with or be disappointed by an aspect of your plan, such as a child whose sibling was chosen to fill a larger role.

   "If the message hurts, at least there's a rationale behind it. If they're at the reading of the trust instrument, that's a tough way to find out," he said.

Tips from multigenerational real estate investors

Members of two multigenerational real estate families share their top tips for navigating the transition process.

Early exposure to the family real estate business matters

Long before Los Angeles-based multifamily investor David Ronen involved his sons Daniel and Michael in his properties, he made sure they understood the family business.

"Even when they were much younger, we talked about the details of what I was doing. Every time I saw an article on the market, I shared and discussed it with them," Ronen said. "I built the interest in them over time."

Prep doesn't have to begin in childhood, but if you hope to see a family business stay in the family, it helps to give successors several years of experience and gradually coach them through the transition, said Jeff Kleinman. He managed his family's Los Angeles apartment buildings with his wife for decades before passing the torch to his daughter Jenny Kleinman and nephew Josh Woods.

Transparency is key

Both current business owners and their successors should be honest with each other during mentoring and training, Woods said. Next-generation leaders need to be willing to ask for help, but it's also incumbent on current owners to create a safe atmosphere to ask and answer questions and, if needed, find the answers together.

"Be upfront with successes and failures, and what you know and don't know. When the next generation has all the information, they're in a position to make the best choices," Woods said.

Be open to the benefits of outside experience

Ronen had always hoped to see sons Daniel and Michael take over his Los Angeles multifamily rentals one day. He discussed the business with them from the time they were kids to spark their interest.

But Ronen waited to formally involve them until they were old enough to understand what joining the family business meant and whether it was a good fit. By that time, they'd graduated from college and started careers.

"It was important to me that they had other interests, and could be successful at those," Ronen said.

The family business doesn't have to be a successor's first and only employer, and branching out can have benefits.

In the Ronens' case, both Daniel and Michael became real estate lawyers—experience Daniel Ronen says he's found helpful in his work with the family's rental properties.

Empower decision-making

If you've spent years building a business, it can be tough to watch a successor change longtime practices or make decisions that differ from your own. But it's difficult for someone to succeed in that role without the power to call the shots, Jeff Kleinman said. Family dynamics can make the situation even trickier.

"If we give them this responsibility but constantly question their decisions, they'll hear it as if we're treating them like they're 10 years old," he said.

He says he's happy to be a sounding board but trusts his daughter and nephew to take the lead.

Be open with family members—including those not actively involved

While Woods and Jenny Kleinman manage the portfolio, their cousins and members of their parents' generation share ownership. Each quarter, Woods shares a report on the properties' performance that outlines factors affecting the distributions family members receive. Keeping everyone on the same page has helped head off any concerns about how proceeds from the business are distributed, he said.

"It's all about being upfront and managing expectations," he said. "Unless there are bigger family problems, most families will understand the people running the business are doing it in good faith."

Ensure your real estate succession plan evolves with your business and family

Succession planning isn't a one-time event; it's an ongoing practice. Your intentions and potential successors' plans might change, so regularly check in with family members actively involved in the business and adjust as needed.

Some families establish a "family council," often meeting on an annual basis, to keep members up to date on business developments and give them the opportunity to ask questions and discuss ideas, Faulkner said. Councils can also help create a common vision for the family real estate business and develop the next generation of leaders.

"Think through your plan now to ensure the prosperity of your business, and your family, is sustained for generations forward," Faulkner said.

Building a succession plan takes a team committed to helping your business and family succeed. Our local professionals can connect you to innovative financial services and market expertise to help you prepare throughout the real estate cycle. Plus, you'll gain access to firm-wide financial solutions to help you execute a smooth business transition. Connect with a banker today.

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