Setting A New Course For A Family Business

The Problem

A family owned real estate company with many Manhattan apartment buildings worth hundreds of millions of dollars had been run for more than a decade by a second generation family member/owner. Despite her extensive experience as an operator, she decided that she needed a seasoned advisor to counsel her strategically about how to best position the family's assets for the future.

The Request

The client asked us to help determine which buildings the family should continue to own, which it should sell, and which buildings, if any, should be converted to condominium or cooperative ownership.

The Analysis

We viewed it differently: our client, at that point in her late 60s and not in the best of health, needed not just advice on managing her family's real estate holdings, but on developing a succession plan for the business itself. Her son, in his mid-30s, was working in the business but had no desire to continue doing so, causing friction between mother and son. The rest of the family, all living on the West Coast, were wholly uninvolved and had no industry knowledge.

The timing of the client's request was quite opportune: it was early 2007, a moment when we perceived that real estate prices were peaking, and doubly so for these prime properties.

In our view the key issues were:
Determining whether there was any feasible, well conceived plan under which the family could continue to own and operate these assets over the long term. If so, then to formulate that plan in detail and assist with its implementation If not, then to assure the assets would be liquidated in an optimal way, not only in terms of price but also to minimize tax.

Helping the client evaluate whether it was prudent even if there was such a plan to have the family's assets concentrated not only in one asset class real estate, but in one sub category, residential properties, and in one location New York City.

To complete our evaluation, besides examining the properties and their cash flows, we interviewed all senior staff at the family's property management organization and analyzed its cost structure.

The Solution

Our analysis revealed that the company's direct property management activities were not being conducted cost-effectively. As a result, it would be possible to outsource that function to an independent property management firm, increase the bottom line by doing so, and in that way leave only asset management overseeing the manager to be handled

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The Solution (continued)

by the family's entity. Because their holdings were so large, the family could then afford to institutionalize an organization to perform that limited oversight function for the long term, with enough depth of senior personnel so that continuity could be assured even if and when our client could not longer carry on. One benefit of that approach would be the family's retaining ownership of a cherished group of assets assembled in a prior generation by its scion.

But the broader issue – determining just how wise it was to stay so heavily concentrated in real estate, and in one market at that   still needed to be addressed.

Our client had always believed that real estate was the only asset worth holding. We offered a more nuanced view. Real estate prices, particularly in New York, had experienced sharp gains – and caution was warranted:

"We presented to her analytics regarding the danger of holding concentrated real estate positions, comparative information about the relative returns on real estate versus other investments over time, a strong case that the real estate assets that she was holding had drastically and disproportionately appreciated in the preceding decade and that such things revert to the mean."

We concluded our presentation with an opinion, offered despite that we had identified a way to re-organize the family business to carry on in the absence of our client:

Given the extraordinary rate of appreciation in real assets in the immediate years prior to 2007, future returns on real estate were unlikely to exceed other, more-liquid asset classes. Drastically overweighting geographically concentrated real estate was unjustifiable and unacceptably risky.

Timing was critical   the markets were overheated, and if the assets were to be divested, even a few months delay could matter.

And so, just as real estate prices were peaking in 2007, we advised our client to rapidly sell the entire portfolio, but first to put in place creative tax-planning mechanisms to reduce the tax consequences.

The Results

The client heeded our advice. The portfolio was promptly sold; but first, we brought in tax specialists and optimized the family's tax planning. By capitalizing on illiquidity discounts and various trust structures, the client not only drastically reduced the tax on sale but also achieved sizeable estate tax savings in future.

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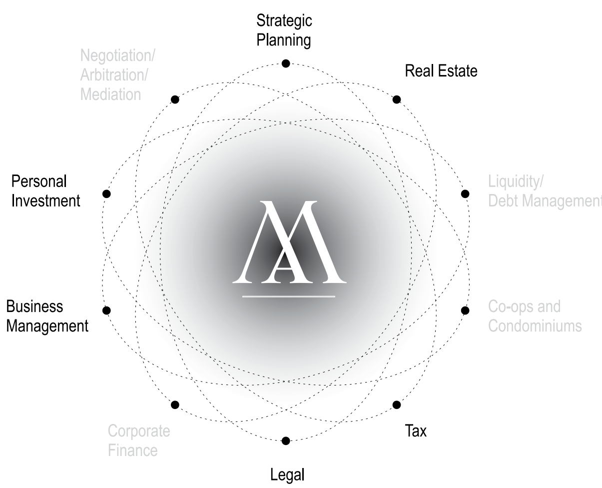
The Results (continued)
By divesting her family's real estate portfolio, our client:

- Freed herself to pursue her true passion her involvement nurturing a charitable organization she had founded.
- Created liquidity for her entire family which had been troublingly dependent on her and enabled them to diversify.
- Her son was able to pursue his true interests as well and their relationship benefitted dramatically.

Areas of Expertise Applied



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