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Control & Ownership For Multigenerational Family Real Estate

When Real Estate is a Family Affair
[and sometimes even a family feud].

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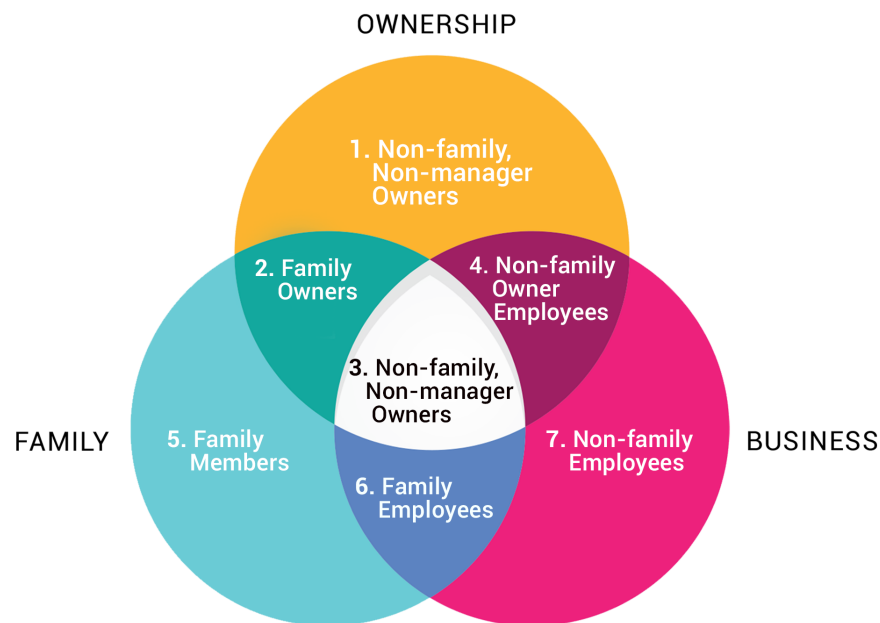
A Family Affair

Let's face it, managing a multi-unit dwelling is anything but simple, especially when it's jointly owned with family [or others]. Over the last 50 years, real estate has helped create significant wealth for what are now second and third generation families and partners. In many instances, the initial builders or founders have passed and left behind their legacy of several buildings of different value with as many as five, ten or more heirs. The founders leave behind assets likely producing declining cashflow [as more and more capital needs to be reinvested back into the aging asset], and illiquidity.

While some second- and third-generation family members may work in the business, many do not. As a result, tensions may arise regarding who is being paid by the family business and who is not. Even if family dynamics are positive, the fact of the matter is that the ownership has gone from one [or a few] founders/developers to numerous second generation family members and possibly to dozens of third generation family members.

With each generational change, there are more and more stakeholders and each of those owners are further removed from the original business. While the original ownership structure chosen by the founder may have been appropriate at the time of development, as subsequent generations take the reins, those structures need to be reassessed and redesigned to best suit the current shareholders. Ideally, this review should be done every 15-20 years as new generations enter the picture.

THE THREE-CIRCLE MODEL OF THE FAMILY BUSINESS SYSTEM



This image identifies the 7 different categories of individuals involved in a family business. Each group will bring different experiences, viewpoints, and priorities to the table. It takes concerted effort to work together to achieve a reasonable outcome for all involved.

Asset Rich, Cash Poor, and No Liquidity

A wealthy client once said to us “It would have been much easier if my father had sold the \$100 million portfolio, bought Royal Bank shares, and had given each of the four kids \$25 million. If he had done that, I’d probably still be talking to my siblings.”

Real estate, by nature, is not easy to exchange for equal value; separating millions of dollars worth of commercial real estate assets into equal pools for the second and third-generation family members is a difficult task. As a result, it’s also one that is often pushed aside and delayed until it becomes a serious problem.

Third-generation owners may be against an all-out sale and separation, but the fact is inevitable, commercial real estate portfolios (no matter how big) typically don’t survive multiple generational changes.

If the owners can agree to a system and process to divide the wealth accumulated by their families, it may not have to result in the sale of all the assets. Many options exist that will allow each shareholder’s goal or objective to be achieved. In many situations, some shareholders want cash and some want to maintain the status quo, while others want to continue to grow the company. With a combination of portfolio split, partial and/or full sale, refinancing and buyouts, we can achieve a solution that benefits all owners and lets each shareholder take charge of their destiny.

Divided Interests Make Dividing Portfolios Difficult

Every family has different needs which are driven by their individual circumstances. Those with children will usually have very different plans than those who are approaching retirement without heirs. Each shareholder needs to understand why they are doing this and what they hope to gain from the portfolio.

Different shareholders may also have varying levels of risk tolerance and a diverse range of passions and projects they wish to pursue. Interpersonal differences or other legacy considerations can also come into play. When various family members are unable to reach a consensus as to next steps for the commonly-owned portfolio, these differences can lead to stress and interfamily tension.

For these reasons it’s worthwhile to involve an outside source to take a critical look at the real estate portfolio, its value, and the best steps to move forward to maintain or improve family harmony. At the end of the day, every partner (no matter how small their relative ownership stake) should be respected as an integral member of the family ownership group. Not doing so can result in alienated owners who are at risk of initiating a unilateral change.

Ultimately, if some owners desire to divest and split from the ownership group, chances are it is going to happen one way or another. The best and most prudent way to move things forward is for everyone to work together in a unified fashion that is fair to all parties, even if it results in the partial split of the portfolio.

First Get All the Facts, then Decide on a Direction

There may be valid and compelling reasons to keep the status quo in terms of company and asset ownership. For instance, when the next generation is working in the management of the assets, even if that is the case, we believe that bringing the relevant data to you and your family for consideration will help inspire confidence in your decision.

There could be missed opportunities to improve management of the property or to maximize revenue. Perhaps there are opportunities to intensify and increase the value of the portfolio. An honest and unbiased assessment of the portfolio's management and value often leads to smarter operation and better overall governance of the family business.

Avoid Falling Into the Trap of "Group Think"

Even well-managed, privately-owned, multigenerational assets will have room to improve. Fully understanding your assets, their current market value, and their future growth potential can lead to positive growth. The best way to take advantage of this untapped potential is to get a third-party party, along with the advice of your advisors, to provide an unbiased assessment of your current practices.



There are three principles to consider when assessing whether the status quo is best serving your interests:

- 1) Are you maximizing the value of your assets under the current structure? We can assess the value of your portfolio and help you understand growth potential.
- 2) Are all stakeholders aligned in their vision? This is key to success, and if it isn't the case, then exit strategies should be considered. The business will not be able to survive long-term in a conflicted environment.
- 3) What about the next generation? Are you passing on a well-operating portfolio or are you leaving them a mess?

Being able to provide a positive response to all of these questions is key to optimal management of your business. If your current situation doesn't align with these three principles, it may be time to consider a new direction. SVN Rock Advisors is here to help you plan a better future.

Problems Grow with Each Generation

Every family is unique, but we have found that many of the families we work with have similar stories. There are consistent trends and perspectives that naturally arise in family-owned portfolios.

While a first-generation family can easily come together to achieve a common goal, the complexities always increase with family size. The initial founders chose to work together while subsequent generations were born into it. As a result, second and third generation owners often have trouble achieving the same consensus their ancestors enjoyed. As the saying goes “you can’t pick your family.”

First generation family members who only hoped to provide a steady source of income for their children and grandchildren, may not have understood how much the value of their portfolios would increase, or the complexities and stresses that might arise as a result.

We have seen situations where family members aren’t even aware they have a problem. In other scenarios they have a firmly entrenched belief that there’s no possible solution. Rest assured relief is within sight, if the right actions are taken with the guidance of an expert team. You can and will get through this!

Don’t Leave the Problem for Someone Else

If the family members of the current generation are experiencing any type of discord, imagine how that will increase in future generations as the family grows. It is a gift to your children to handle the situation now rather than push it off to a later date.

Taking the time to consider your situation and your options is important not only for your sake but more importantly for your children and grandchildren. The complexities will only increase over time. A solution is there, it just requires everyone to look for it.

Find an Experienced Real Estate Quarterback

We have worked closely with dozens of families and real estate portfolios over the past 25 years. Through it all, we have learned how to efficiently and effectively deal with the unique aspects of different family dynamics.

The process of valuing a portfolio and considering reorganization or disposition options is complex and requires a strong team of professionals with a diverse range of skill sets and expertise. For the best results, you’ll need a multitude of advisors to provide tax planning advice, real estate analysis, and corporate split options just to name a few.

Other specific expertise will be required (environmental reports, appraisals, third-party property managers, etc.). These professionals tend to work in silos so are not able to see the big picture—this is where we come in. We connect the dots and manage the process.

World Class Systems and Processes

Over the years, we have developed an exclusive process based on our unique experience, knowledge, and skills to best serve families in situations like these. We are not a typical brokerage firm using worn-out, conventional processes that only work when conditions are ideal. Rather, we are a dynamic team of innovators with the goal of creating real value for our clients.

We provide a wide range of consulting services as well as brokerage services, if ultimately required. We know that when families embark on this journey without an external facilitator, they will see slow progress and duplicated work as a result of poor communication and lack of management. Our aim is to make the process more collaborative and transparent wherever possible.

Sometimes, when a stalemate occurs owners can't make a decision on how to move forward. We provide leadership and help you find the "bold moves to get the process going." Ideally, we move forward with full consensus but when one party cannot find common ground, we can. In this situation it would be an inverted process that can still lead to a positive outcome but is more complex to execute. An overview of this process is included on the next page. We have successfully executed deals with this process, but it is just one of many unique processes we can work through with you.

The Cherryhill Transaction



<https://www.youtube.com/watch?v=-7Cu5NSRRVMg>

"This was my Dad's legacy... this was way more to us than just a business. It was not a light decision [to sell]. Derek went through a list of very reasonable things to make us reconsider [selling] and when he was finished, in my mind, I thought, I think he's right."
-Harvey Katz

The Williams Court Transaction



https://www.youtube.com/watch?v=j_wxTE_jyGk&t=1s

"Derek always follows his clients very closely. He's not just a broker that will come and disappear when the deal is done - it's an ongoing relationship. [We] have known each other for close to 15 years." -Francis Lépine

Methodical Steps Towards the Future

Here is an overview of our unique process. We have successfully executed deals with this workflow and it's just one of many options we can deploy to help you succeed. Remember, you don't necessarily have to sell to solve your problems.



While every family is unique, we have a process and methodology to work through so that every party is satisfied. This diagram sets out one such process we can employ with your family.

We have seen situations where the family sells the entire portfolio and shares the profits. We have also seen families split the assets where some family members retain their properties and others sell. We have seen owners who have gone through the valuation process and chosen to maintain the current ownership structure while some owners just divide the assets, and each party runs their own business independently. While the outcomes of these circumstances are never identical, the need for a process is constant. Our years of experience have taught us what works and what doesn't work. You could call it our recipe for success, and we want to share it with you.

A Network of Trusted Experts

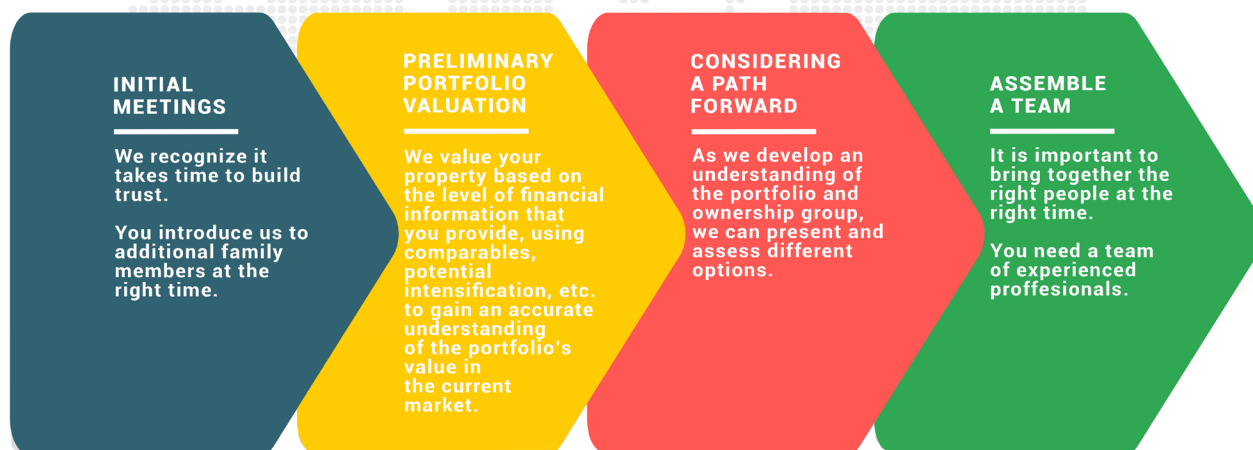
As one of the most-connected individuals in the real estate industry across Canada, I have built a network of trusted relationships that allows my team to serve you better. We have the experience and unique qualifications to handle complex ownership situations. We understand that this is a long-term process that requires out-of-the-box thinking. Results rarely take less than a year.

Communication, Relationship, Transparency, and Trust

Our services have evolved over many years of serving the commercial real estate industry. We aren't cold callers saying "Hi, it's Derek calling from SVN Rock Advisors. I understand you own five buildings, two retail plazas, and one office building in Toronto, when was the last time you saw your brothers and sisters?" Most of our clients are ones we have consulted with in a different capacity in the past and who have now come to us because of the tense relationships they are experiencing, or they are brought to us by one of their advisors.

When we meet with that client, we are transparent as to what we're going to do, how we're going to do it, and how long it's going to take. We have also found that maintaining a level of neutrality is important so family members feel that everyone's needs and feelings are being considered. In some cases, remaining neutral is almost impossible but the process is still executed. We are able to successfully manage both scenarios.

Getting Started On the Right Path



Initial Meetings

We realize that family dynamics are personal and normally quite private and we adhere to strict confidentiality standards. We seek to build a trusting relationship and to understand the family dynamics and history at play. We realize it can take time to develop an open and trusting advisory relationship—our goal is to ensure that you feel understood and supported. When the time is right, we can expand or “right-size” the circle, meaning that we can start meeting additional members of the family—another important step in moving towards a potential solution. Most of the time, these meetings are at the kitchen table rather than a boardroom. But if the relationship is not well-maintained, the meetings may end up at a lawyers office. Lawyers will be necessary at the right time, but it is critical that family members don't just “lawyer up” from the start.

Preliminary Portfolio Valuation

As brokers, we are skilled and experienced in underwriting properties. Even if you are only able to provide high-level financial statements and we can only drive by the properties rather than tour them, we can use estimated expense numbers and market data to estimate the value of your portfolio in the current marketplace. Sometimes we can start with just the annual financial statements. Of course, the more information we receive, the more accurate the valuation will be.

Often, our valuation will include consideration of site intensification or improved property management practices and in the majority of cases, our clients have been surprised and pleased to find that the value of their portfolio is higher than they had expected, especially if these clients were not involved in the business personally.

Finding Ways Forward

As discussed above, there are a number of different ways forward, and these will be considered as appropriate to the circumstances. In the event of deciding to separate the real estate assets, the best way to move forward would be with 100% consensus from the ownership group. A process by which the properties will be valued, allocated (and/or bought out) and finally separated would be agreed on and the parties would move forward in good faith. This is the cleanest and best way to both achieve an optimal solution and maintain family harmony.

Many times, this isn't possible, and the partners with less authority are not able to get the attention of the managing partners. In this case, the partners who are looking to make a change can engage us to get the process started. We would do our analysis of the portfolio, provide real time market data and statistics, and present various strategies to the entire ownership group. [i.e. selling the portfolio to buy out partners who want out, refinancing, splitting the physical assets, creating a payment plan to take out minority partners, etc.].

Knowing When and If to Sell

You may wonder if it is the right time to sell, and have concerns about current market conditions.

If choosing to sell, it is important to know that you are not insulting the founder or abandoning the family legacy. You are converting assets into another form and maximizing the asset. This, we are sure, would make the founder proud!

Right now, apartments and industrial properties are in favour with investors and retail and office properties are out of favour—or at least suspended until valuations can be more certain.

Perhaps when you think of a broker, you think of someone who is always saying that it is the right time to sell and has been saying so for the last 20 years. Our aim is to be your advisor—we'll give you our best insights on market conditions and you use that advice to make the best decision for you and your family.

Carefully Build a Team of Trusted Advisors

Assembling a qualified and experienced team is key to accomplishing your goals and achieving a solution that satisfies all parties. The diagram below sets out some of the key people you will need at different stages in the process.



You will need many different advisors throughout the process, and you will need a quarterback to manage them all.

As the quarterback for the process, we will take the lead role in coordinating with all advisors and keep the process running smoothly. As someone with an outside perspective, we can see the big picture better than an owner who is closely involved. We can also coordinate with other trusted advisors you may already be working with.

If the proposed solution includes a sale of properties, we can act as the broker, but this is not required if you have another broker in mind who you wish to work with. In either case, we are

only paid when an outcome is achieved and so we are motivated to provide the best service we can and achieve a workable solution as quickly as we can.

When building a team, our advice is to try to set up a creative payment schedule for all team members so that everyone is aligned towards the results you want. This means trying to measure progress by milestones achieved, rather than time spent on the deal. Through our experience and professional network, we will get you the best help and team of advisors. It is worthwhile to spend the money to get the right advice, rather than go with a less-expensive option. In some cases, the compensation structure for the other professionals can be done in such a way that minimizes ongoing expenses (in order to help with cash flow) with a large component of the compensation coming due once the properties are sold or a solution is otherwise achieved.

Paying more for qualified professionals will save money in the long run as it will achieve optimal results faster and will ensure that the outcome is fair. Indeed, if the founders had used resources to get better advice, you might not be in the situation you are in today. We will help you determine the right time to bring in lawyers, accountants, tax specialists (early!), appraisers, financial advisors, mortgage lenders, and other key experts.

What You Need to Know

As much as we can help simplify this process, it is critical for shareholders to have realistic expectations. We've said it once and will say it again and again—these are complex situations. There will be compromises, hiccups, and unexpected twists and turns. It is important to focus on your priorities and be flexible with the things that are less important to you.

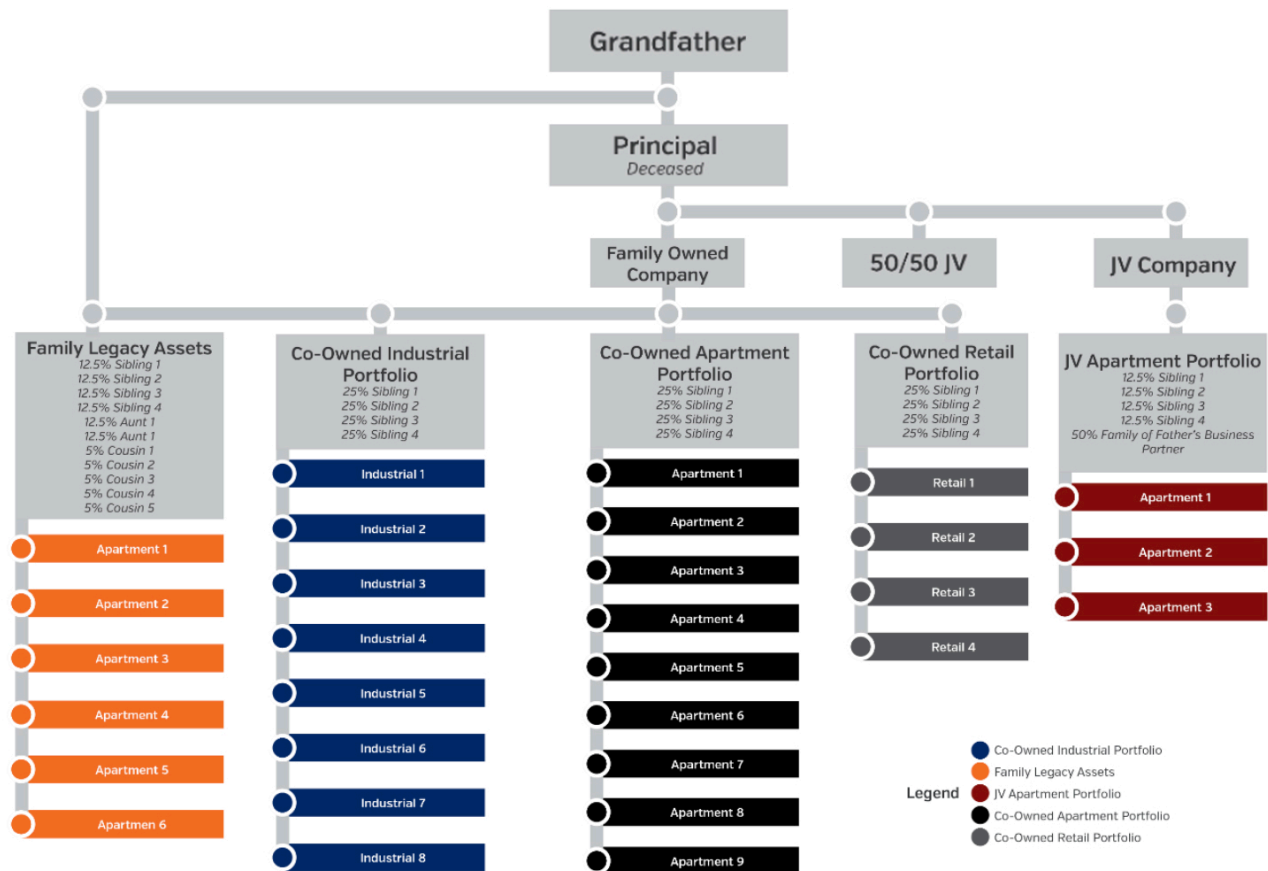
For example, if you know that a certain property is one you wish to retain, you can prioritize retaining that asset while being flexible with other properties in the portfolio. It is important to understand that the solution will be one that all parties can agree to and that your starting position will not be the final outcome. Knowing how to prioritize your objectives is key to achieving a solution you and everyone else can accept.

Don't Ignore Taxes

If there's one thing we want to stress, it is to address taxes early. Often, the tax burden can be the thing that is holding you back from considering a disposition. The potential for paying recapture and capital gains tax can be discouraging to you and your partners.

We can introduce you to various tax professionals with creative ways to achieve your goals and minimize your tax burden. Any of these specialists will tell you that it is vital to think about taxes early in the process, to be able to optimize your outcome. If concern over a large tax bill is one of the main things holding you back from considering a disposition or other change to the status quo, consider that the record government spending we are seeing now will likely lead to even higher tax bills in the future, so now may be the better time to take action. Whether or not you can see the outcome, start thinking about taxes and how you will deal with the implications of your settlement as early as possible.

Case Study



Above we have included a sample corporate ownership structure of a family business that we recently worked with. *In the interest of confidentiality, the asset classes, number of properties and relative ownership stakes of the partners have been changed.*

As can be seen above, no single family member owns 50% or more of any given asset. There was a portfolio of apartment buildings (called the Family Legacy Assets) that were owned by four siblings along with seven other family members which were inherited from a common grandparent. The remaining assets were built and developed by the principal who has now passed it on to four other family members who now own 3 different asset classes. Not one single family member has a controlling share. Furthermore, 3 of the 4 siblings are not even involved in the day-to-day management of the business yet receive the same cash flow due to the equal ownership stake. To complicate matters even more, there is another apartment portfolio owned by the 4 siblings on a 50/50 basis with another family (former business partner of their father).

As can be seen above, this is a very complicated and diluted ownership structure in need of restructuring. Imagine passing this situation on to the fourth generation where there will be dozens of owners. The prudent thing to do was settle the estate.

Think About the Next Generation, You Don't Want to Leave a Mess For Your Children

If the chosen outcome is a disposition or a split of assets, you are going to be coming into a considerable amount of wealth. This has the potential to affect your own immediate family dynamics. Just as you have found yourself in a complex situation, your next generation could also experience many of the same issues.

We can put you in touch with excellent organizations that can help you consider the big picture and how the business can grow with your family. This process involves setting up appropriate governance structures, defining family values and objectives, and of course, managing the actual family business and/or funds.

These types of organizations can also be helpful in the event that your chosen outcome is to separate the assets but still allow for joint family business ventures and investments on a case-by-case basis. Having structure and guidelines in place ahead of time will allow for these partnerships to operate more smoothly while keeping intact, and even strengthening, family relationships.

As we reach the intended outcome—disposition, split of assets, or whatever it may be—it can be tempting to rest on your laurels and enjoy your well-earned purchase price. We strongly suggest that in addition to enjoying the fruits of your labour, you also take some time to think about the next generation, and the simple steps you can take now to help them avoid the situation you experienced. Consider and establish how you will address the following three areas:

- 1) **Openness** – Have an honest discussion with all of your immediate family members regarding the wealth that has been created. This is an opportunity to educate family members about the family history and ensure they understand the responsibility of not only prudently managing the wealth but importance of communication so that family relationships can remain intact.
- 2) **Opportunity** – Establish a transparent process (including decision-making) for all family members to share what entrepreneurial or philanthropic pursuits are of interest to them. Help them define their goals. Consider an amount or a pool of assets that could be available to family members to support their pursuits. Ensure the family members are prepared and have the tools to successfully receive and manage the assets.
- 3) **Sustainability** – Make sure your family's wealth is sustainable. Take a multigenerational approach to managing the majority of your wealth or core capital. Consider hiring an investment management firm experienced in working with pensions and high-net-worth families. They can provide investment expertise when it comes to multigenerational planning and will have the fiduciary responsibility to oversee your wealth. This can establish a road map for you to ensure that your heirs will thrive.

Next Steps:

What Now?

If any of this has resonated with you, please give us a call. We do not charge any fees until you reach an outcome, so there is no risk involved in starting the process.

We want to help you and your family find a way forward and we have the skills, resources, and experience to make it happen.

Thank You

I would like to acknowledge the following people for their contributions, conversations, and inspiration in the creation of this content:

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Teanna Lobo - **SVN Rock Advisors Inc.**



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Below is a series of short videos outlining our unique process for Control & Ownership within Multigenerational Real Estate:

Go to svnrock.ca/families and use the password **families2021** to access the videos.



1. Multigenerational Family Real Estate



2. Control & Ownership



3. Value The Portfolio



4. Initiate The Process



5. Assemble The Team



6. Planning Your Future



7. Align Family Interests



8. Fees & Timelines



9. Taking The Long Term View



10. Why Can't I Do This Myself?



11. Confidentiality Agreements



12. Strategies For Minority Partners

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