ACCEPTING IN-KIND GIFTS OF REAL ESTATE

For a nonprofit organization (nonprofit), effective fundraising is critical to furthering its organizational mission. But like a Trojan horse, not every gift offered should be accepted.

Understanding the extent of your potential obligation and ability to liquidate the asset will help you decide whether to accept or decline the gift.

Some gifts, such as the donation of a house or other property may come with environmental liabilities which could result in financial costs or legal liabilities. Care should be taken to ensure that gifts do not cause reputational or financial risk for the nonprofit. A well-written gift policy statement can minimize headline risk or negative impact to an organization's bottom line. For cash and other liquid asset donations, it is generally a non-issue. However, many nonprofit organizations do not have the expertise to evaluate real estate or other illiquid donations prior to acceptance.

In addition to establishing written gift policies and procedures, a preliminary list of questions can help an internal advancement team evaluate a nonmarketable asset donation to quickly determine whether additional due diligence is needed prior to acceptance. Some of the critical questions to ask include:

1) What type of gift is it? Recognize that there are gifts that are generally not worth accepting. This includes cemetery plots and time shares, but also may include working interests in wells, private equity interests, or shares in closely held operating businesses due to illiquidity, reputational or financial risk. Working interests, private equity or closely held operating businesses all could require capital commitments that you as the owner would be required to fund. Understanding the extent of your potential obligationand ability to liquidate the asset will help you decide whether to accept or decline the gift.

2) What type of interest is it? Fractional interests will require you to get approval of the other owners to liquidate an asset or may require you to file a partition action if other owners are unwilling to sell. This could be time consuming, will require legal fees and could expose you to reputational risk.

3) Are there conditions attached to the gift? Any conditions placed on a gift can help you decide to accept or reject it, or to request additional information prior to making a decision. For example, if your organization is offered a gift of vacant land but it includes a condition that it must be retained for several years, understanding the carrying costs will help you decide whether to go back to the donor to request that they also fund the costs associated with the gift.

4) Are there title restrictions, easements, life estates or licenses that may impact the ability to liquidate the asset? The ability to liquidate the gift is important because otherwise the incurred carrying costs may have negative financial repercussions and thereby detract from the organization's bottom line. Timberland encumbered by hunting rights may preclude a sale of the property without buying out the rights holder or identifying a buyer willing to purchase the property subject to those rights. Hunting rights will negatively impact the value of a property and may not make acceptance of the gift practical from a financial standpoint.

Understanding the carrying costs will help you decide whether to go back to the donor to request that they also fund the costs associated with the gift.

5) Do any environmental issues exist and has the donor provided related environmental reports? If the donated property is not a platted residential vacant lot or single family home, some level of environmental due diligence should be performed. Copies of existing environmental reports, and No Further Action letters issued by the state or federal environmental agencies help determine the level of risk and identify what other additional information is required. There are low cost threshold reports that can be obtained to help determine whether a full blown Phase I Environmental Assessment is required. Discussions with the donor to fund these reports and/or assessments should occur up front.

6) Is there debt secured by the asset? Debt carries Unrelated Business Income Tax implications for charitable organizations so it is important to understand both the level of debt and whether there would be any prepayment penalties associated with an early payoff. Again, the ability to liquidate the asset and the time frame for completing a sale are critical to your acceptance decision.

7) Where is the property located? A real estate donation could be located in an area where liquidation is nearly impossible. (i.e. a residential lot next to an expressway) This could result in long-term carrying costs such as real estate taxes, insurance, etc. Many states no longer permit a property owner to ignore real estate taxes and then forfeit the property. Depending on the location, it may also be impossible to give the property away to adjoining landowners, municipalities or other charities.

8) If the property is income producing, what are the current uses? Can you obtain financial statements or tax returns (preferably the last 3 years)? Can you obtain lease abstracts and/or a tenant roll?

9) What due diligence should be undertaken? Beyond environmental evaluations, consider a property inspection as well as a formal property appraisal. Consideration should be given to the location, market conditions, vacancies, tenants, financial performance (over 3 years) as well as deferred maintenance/capital improvements and carrying costs. Entity structure, ownership and control, as well as title considerations should also be reviewed and considered. All of these factors can impact the ability to liquidate an investment and could also carry some capital commitment that could negate the value of the gift.

10) Is the gift a condominium or shares in a cooperative? Is it currently occupied or leased? Review owner bylaws and declarations, particularly those that address ownership and sales, and terms of any current lease(s). It is advisable to conduct a home inspection to ensure that there are no issues to be addressed prior to sale such as mold, electrical problems, water seepage or other capital intensive repairs.

11) Can the gift be liquidated? Understand the market conditions for the property based on its current condition, and consider the upfront costs required to ready the property for sale.

12) How will the gift be managed until it is liquidated? A property needs to be located where professional property management can be hired and supervised. How will this expense factor in to the overall value of the gift to the organization? This should be understood prior to acceptance. If the cost is significant, the donor may need to cover a portion or all of the anticipated costs.

Consideration should be given to the location, market conditions, vacancies, tenants, financial performance (over 3 years) as well as deferred maintenance/ capital improvements and carrying costs.

GETTING STARTED

In-kind gifts of nonmarketable assets can be a great source of funding to further your organization's mission. Northern Trust can provide you with advice on best practices related to nonmarketable gifts ranging from real estate, oil, gas and minerals as well as closely held investment interests that could transform your planned giving strategies.

Our staff includes CPAs, attorneys, CFAs, CCIMs, CPMs, Certified Landmen, petroleum engineers, farm managers and architects. We have the experience and knowledge to counsel you on acceptance of nonmarketable assets, and to work with your attorneys and other professionals, such as brokers, appraisers and property managers. Capitalizing on our experience can guide you through this process to evaluate the potential risks and benefits of a nonmarketable in-kind gift.

Our Special Asset Teams develop policies and procedures; perform due diligence and make recommendations for clients regarding nonmarketable assets nearly every day. If you are a nonprofit organization, we can work with you to evaluate these special assets, even if you don't currently have a gift asset in question. **To learn more, visit northerntrust.com/FIA.**