

How a Real Estate Gift Can Provide Lifetime Payments

Recently, Dr. Sterling Kerr, Director of Gift Planning for the AARP Foundation was contacted by an AARP member to explore the use of real estate to fund a charitable gift annuity.

She wanted to know how a gift annuity works. He explained the following: She transfers all her interest in real estate to the AARP Foundation which in turn contracts to make fixed annuity payments for the remainder of her, or if there is a spouse, their lives. The rate of return is determined by age and whether one or two lives are involved. She was cautioned that once the real estate is transferred it become the property of the Charity and will never be available to other family members. Usually with property gifts the rate or the value of the gift is negotiated down to reflect closing costs. Once a gift has been made she is entitled to a tax deduction. The unused portion of the tax deduction is carried forward for five years. The advantage of making a gift of an appreciated asset is that the taxable capital gain is avoided at sale. The gain is spread out proportionally over her life expectancy and shows up as taxable income.

An alternative for younger donors under age 60 is to elect a deferred payment gift annuity, say until age 60 or 65. The tax deduction is available in the year of the gift, but payments start later. The income tax deduction is generally equal to the difference between the fair market value of the property and a calculation based on the present value of the annuity payments.

She elected to go forward with the gift

Case Study

The property owner was a single female age seventy-five with no heirs. The donation asset was a beach community rental property with a fair market value (FMV) of \$800,000 subject to a \$200,000 mortgage. Rental income was well below the market but the owner desired stability of income rather than risking vacancies. The owner/landlord was responsible for property taxes, insurance and maintenance plus acting as the property manager. After the mortgage payments and overhead expenses were made an income of only \$800 per month remained for the landlord. Because of the burden of management and small return on equity the property owner wished to increase the supplement retirement with higher payments available through a gift annuity. She also wanted to be able to help the AARP Foundation in its effort to improve the lives of the aging.

Options for the owner:

1. Sale: Sell the property and reinvest the "net" proceeds safely which produces taxable income:
Sales price \$800,000

Less mortgage pay off of \$200,000
Less costs of sale \$80,000
State and Federal Capital gains tax (22%) or
\$110,000

“Net sales proceeds” \$410,000 invested at 5%
Produces \$1,708 per month

2. Exchange: Locate and negotiate an IRS Section #1031 tax deferred exchange. This may improve her income stream, but will not eliminate ownership and management concerns.
3. AARP Foundation charitable gift annuity: donate the asset in exchange for life time payments made by the AARP Foundation:
 - Donation at FMV \$800,000
 - Less the mortgage of \$200,000
 - Less costs of sale \$80,000

A negotiated amount of \$520,000 funds a charitable gift annuity which pays \$3,166 per month with a portion of the income sheltered for six years by virtue of the charitable gift tax deduction carried forward.

The donor entered into a contract donation with the Foundation. Their national real estate consultant, Chase V. Magnuson, facilitated the transaction by retaining the services of a local real estate professional to market the property. A buyer was found and the donation was completed within six months of the initial contact with the Foundation by the donor.

Real estate gifts have proven very challenging for most charities. The AARP Foundation anticipates the difficult issues with each transaction and has detailed policies and procedures in place to accommodate the donors. In addition to the policies they have interlocking teams of professional service providers to help complete every phase of the donation process.

Should you be interested in discussing a potential gift of real estate please call:

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