Vacation Home Succession Planning Can Be Serious Business

A family's vacation property can have a subjective value to family members that far exceeds its financial worth, presenting unusual estate planning challenges.

DAVID W. BURLEIGH

In the world of family enterprises, family vacation properties occupy a distinct place. A piece of family vacation property is not a for-profit enterprise, like an operating company or a family investment entity. Nor is it a family charitable enterprise, like a private foundation or a charitable trust. A family vacation property is its own type of family asset. As such, it deserves its own structure for decision-making, succession, and managing transitions within a family.

The idea that a family vacation property needs its own governance structure presupposes that the property is essentially a legacy asset. "Legacy asset" refers to an asset the family owns because a significant component of the asset's worth is its *nonfinancial* value to the family. That is, the family owns the asset not primarily to make money or to save money, but for other, nonfinancial reasons that hold great importance for the family.

This does not mean the property has no financial value on a balance sheet. The property may be worth a lot of money. Presumably a family member once bought the property expecting it would increase in value. Most people do not buy vacation properties in areas that are projected to become less desirable. Rather, the point is that the family intends to keep the property for the long term despite its financial value. They do not intend to sell it soon simply to make a profit. They intend to keep it for the long term because it means something to them.[1]

Why family vacation properties are distinct

The principal reason family vacation properties are an asset unto themselves is that they are the site of a distinct type of activity: leisure. Nowhere else do family members go for the purpose of *not* engaging in work. In contrast, family members enter a for-profit family enterprise, such as a closely held business, to make a living, to preserve and enlarge financial capital, and to have employment for themselves. With a family charitable enterprise, family members also perform work—maybe not compensated work, but work. For example, they work in making charitable donations, pitching in on charitable boards, supporting non-profit research, organizing charitable events, or simply by volunteering. With a family vacation property, by contrast, the family members use the property for the purpose of enjoying some leisure. Any work at the property—such as repairing weather-beaten siding, buying fuel for a boat, or even cooking food for a hoard of hungry grandchildren—is incidental to the enjoyment of leisure.

DAVID W. BURLEIGH is a consultant with Withers Consulting Group, which advises enterprise-owning families on issues of governance, succession, and transitions. To contact him see www.withersconsulting.com.

The shared experience of leisure contributes to a person's sense of place, which in turn strengthens the person's sense of being grounded. The more technological modern life becomes, the more mobile we become in our work, and the more connected we are to web-based images and data in our work, the more the tangible, physical places surrounding us matter—precisely because we assume, incorrectly, that the places are interchangeable when they actually are not.[2] In fact, physical places have an "inherently phenomenological character."[3]

Attachment to a place. "Phenomenological" refers to human beings knowing the nature of a place through its appearance, especially as a person perceives the appearance through the five senses. People identify more with the appearance, sound, feel, and smell of a place than they realize. Consider, for example, the sight of early-evening sunlight across a large lake, or the sound of wind blowing through trees in the summer, or the salty smell of an ocean beach in the morning, or the taste of water from a well that serves an old cottage. A physical place resonates with a person, especially when the person is at the place for the purpose of relaxing.

One of the best examples of this resonance is a short essay by the writer E.B. White. Known for witty articles in *The New Yorker* and children's books such as *Charlotte's Web*, White also wrote "Once More to the Lake," a little piece about revisiting with his young son a lake where White himself had vacationed as a child.[4] White illustrates the phenomenological character of the spot:

> On the journey over to the lake I began to wonder what it would be like. I wondered how time would have marred this unique, this holy spot—the coves and the streams, the hills that the sun set behind, the camps and the paths behind the camps.... It is strange how much you can remember about places like that once you allow your mind to return into the grooves which lead back. You remember one thing, and that suddenly reminds you of another thing.

Initially White finds comfort in the sameness of the place:

> Everything was as it always had been.... There had been no years. The small waves were the same ... and the boat was the same boat, the same color green and the ribs were broken in the same places, and under the floor-boards the same fresh-water leavings and debris....[5]

Yet White is not a sentimentalist. During the rest of the essay he finds himself coming to grips with the changes to the place, and the fact that he no longer is the age of his son. White concludes with a jarring observation that he is moving ever closer to his own death. Precisely for this reason, he is grateful to have experienced, along the path of his life, the continuity of the place.[6]

White was but a renter at the lake. He and his son stayed just a week. Yet his essay points up a fact all vacation property-owning families inevitably must confront: The place where this distinct experience of leisure occurs is a finite resource. It is never available for as long as one might prefer. After a while the press of work calls. If nothing else, eventually undesirable weather sets in. (Hence some families have multiple vacation properties in different climates.)

Proactive planning needed. Maintaining a place, and a sense of place, is as much an achievement as a given condition.[7] It takes proactive planning. It does not just happen. This is all the more true if a person wants to share use of the place with other members of the family—all of whom have their own schedules and lives. In order to restore one's sense of being grounded via the enjoyment of leisure at a vacation place, and recognizing that the place is a finite resource, a family needs to have a system for making decisions together about the vacation property itself.

Each family brings its own attitudes about what it hopes to get out of owning the vacation property.

Practical considerations

A well-conceived governance structure for a vacation property involves many practical issues. The basis for all of these is: what kind of structure fits *this family?* Every family is different. As with a family business, the question is not what decision-making structure works for the business across town or the competitor in another country. Instead, the question is *how this particular family makes decisions together.* Even before a family buys a piece of vacation property, the family already has certain ways it makes decisions. One must pay attention to these natural ways of operating.

Identify family dynamics. A second fundamental question is: what *kind* of legacy asset-owning family do we want to be? Each family brings its own attitudes about what it hopes to get out of owning the vacation

[1] For further discussion of concept of legacy asset, see Burleigh, "Governance For Legacy Assets?," www.wealthmanagement.com, 11/12/2014.

[2] McClay and McAllister, eds., *Why Place Matters: Geography, Identity and Civic Life in Modern America* (Encounter Books, 2014), pages 1-9.

[3] *Id.*, at page 3.

[4] White, "Once More to the Lake," (published in, among other collections, Smart, *Eight Modern Essayists* (St. Martin's Press, 1985)).

[5] *Id.*

[6] *Id.*

[7] McClay and McAllister, *supra* note 2 at page 3.

property. For example, some families view ownership of the property in terms of management by a small group of family members. The extended family entrusts management of the property to one or two of their own. The rest of the group would prefer not to be involved in the management, and the group trusts the one or two. Meanwhile, the one or two people entrusted to be managers like to manage the property. They enjoy being hands-on in interacting with contractors or property management firms.

Other families like governing the day-to-day management of the property. Rather than simply delegate, they all want to have a say. They reason that they all occupy the status of owners, so they all should be involved in making decisions. Such families benefit from clear rules and strong policies about what will happen.

Still other families, whose investing mindset carries over to the property, keep the investment value of the property ever in mind. They want it to be in top shape to preserve its financial value.

To make the matter more complicated, in any given family, each of these attitudes may exist. For instance:

- The senior-most member, age 82, might prefer delegating upkeep of the property to his daughter, age 55, who supervises an outside property manager.
- His spouse, age 76, might enjoy her status as an owner and want to have a say in how the property is kept.
- Their son, age 52, may be good at doing maintenance work himself, and except for the father and the daughter, the rest of the family sees the practical and financial advantages of letting the son deal with it—so long as the mother has a say.
- A daughter-in-law, age 39, may have an investing mindset and always be concerned about the market value of the property.

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Sorting out which attitudes predominate across an entire family is not always a straightforward task.

Those attitudes that prevail in a family will affect what kind of decision-making structure fits. For example, a family that simply wants to defer to a small group will have less need to voice input. A family where the members want to have a say will be better suited to a structure that encourages input from a broad group of family members. A family that keeps its eye on the investment value of the property may have a greater need for discussion about the property within the family, at least if ownership is spread broadly across its members.

Ownership structure. Two common legal structures for owning vacation property are an irrevocable trust and a limited liability company (LLC). Each aligns with a distinct way of making decisions within a family:

- An irrevocable trust is a more hierarchical way of making decisions. The grantor sets up the trust, the trustee attempts to carry out the grantor's wishes, and the beneficiaries occupy a relatively passive role. Even if there is a trust protector or an advisory committee, the decision-making structure proceeds from the grantor.
- An LLC, by contrast, is more democratic. The company is either member-managed or manager-managed. In either case, over time a broader group of family members participates in deciding what to do.

The differences between these two structures have practical significance. An operating agreement for an LLC is much easier to modify than an irrevocable trust agreement. Typically the latter will require at least a private settlement agreement if not multiple probate court hearings. When family members disagree, an irrevocable trust involves more cumbersome dispute resolution than an LLC. An LLC also facilitates scheduling use of the property.[8] These features would seem to make an LLC preferable. Yet for a family that by nature operates according to a more hierarchical type of rule, an irrevocable trust may fit the family culture better.

Who uses it, and who pays?

After deciding who sets the rules and who enforces them, the next step is to determine who will use the property and when. That may involve addressing the following issues:

- In any climate, "peak season" lasts for a finite number of weeks. How long will any one member of the family be permitted to stay during this time?
- How will the family adjust for changing non-vacation schedules of its members from year to year?
- What special arrangements will aged or disabled members of the family need?

[8] For an excellent chart comparing the features of various legal structures for owning vacation property, see Fry, *Saving the Family Cottage*, 3d ed. (Nolo, 2009).

- What are the family's attitudes toward guests, step-children, adoptees, divorcees, and surviving spouses?
- What rules are needed to reflect these attitudes?

The family will need to decide these questions so the authority who schedules use of the property—whether that is a trustee, an LLC manager, or some other authority—knows what instructions to follow.

Money matters. How to pay for ongoing maintenance of the property is an equally, if not more, significant question. In fact, over time the issue of how to pay increasing expenses may become the most significant question. Family vacation property exemplifies the lesson that no matter how much money a family has—whether $1 million, $10 million, $100 million, or $1 billion—there really is no time when the family can relax permanently and place itself on autopilot.[9] Eventually the vacation ends.

In the broad sense, the "vacation" may not end until a future event during a subsequent generation in the family. But it will end. Meanwhile, use of a vacation property is never free. Someone has to pay for the maintenance. Those who manage the property, whether they are family members or outside contractors, will need to set an annual budget.[10] Whether payment should come from a pre-set maintenance endowment or a currently active source of money, such as distributions from an operating business or contributions from trust beneficiaries, is itself a very significant consideration. An endowment eases pressure on distributions from current cash flow, but an endowment also assumes a certain spending rate and a certain rate of return. On the other hand, paying for maintenance from current cash flow of other holdings requires the various family members to have a grip on their own spending and investing.

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Communication is crucial. These two issues—scheduling use of the property and paying for maintenance—point up the distinction between the family members themselves and the actual owners of the property. If a trust or an LLC is the legal owner of the property, the legal owner is not the family itself. Just because there is a legal structure for ownership of the property does not mean there is a forum for family members to discuss their concerns about the property and their relationship to it.

In large families a family council may be advisable, in addition to whatever legal entity owns the property. Even small families must avoid thinking that a legal entity for ownership eliminates the need for family members to communicate with one another about the property.

Getting out, and other end-time concerns

Beyond these two issues is the set of questions pertaining to exiting from the enterprise. Each of these is more complicated than it first appears.

- How will ownership interests in the property transfer when family members die or wish to dissociate from the enterprise? Who may buy out whom, and on what price terms? If the purchase is over time, may the buying family member use other co-owned family assets to finance the buyout?
- Should a discount apply? Is a discount justifiable if both seller and buyer received the ownership interests as gifts? How does a discount correlate to the family's attitude about the property being a legacy asset, and not simply a financial asset? For example, if the family sees itself as more a steward of the property than investor-owners, a discount might be warranted to discourage family members from thinking about getting out on short notice.
- If all ownership interests were inherited, does renouncing an interest in the vacation property entitle the person to "credit" of a greater share in another asset?
- What transfers are permitted for purposes of planning the estates of subsequent generations?
- How do permitted transfers implicate the family's attitudes about use of the property by divorcees, surviving spouses, and adult step-children?
- May transfers occur only within branches of a family, or may transfers occur without regard to branches? How, if at all, will exiting from the family vacation property affect exiting from another

9 For a superior, detailed analysis of this point, see Lucas, *Wealth: Grow It, Protect It, Spend It, and Share It*, 2d ed. (FT Press, 2013).

10 For an example of five generations of a large family (250 people) addressing maintenance costs of a 1902 vacation house in upper New York state, see "How to Own a Vacation Home—With Someone Else," *Wall St. J.*, 6/15/2014.

family enterprise, such as a family business?
- How will the family adjust its intention to keep the property if adjacent property owners make adverse development decisions? What happens if the actions of neighbors, ownership associations, or real estate developers severely change the phenomenological character of the place and reduce its appeal for the family?
- How will the family handle succession issues that arise for owners of nearby properties?

Financial downturn. Related to these is the problem of financial downturn. Over the course of multiple generations in a large family, some family members may have trouble handling money. (To the extent their trouble results from not having enough exposure to economic scarcity, the fact that vacation property is a finite resource can help mitigate this tendency.) One thinks of creditor problems, financially draining divorces or business failures, and personal bankruptcy. Yet financial troubles need not be individual. Sometimes they relate to downturn in a family business or a family investment entity. This is particularly a problem where cash flow from a family business or a trust pays for maintenance of the vacation property. In any case, the governance structure for the vacation property needs to account for what happens when a person's or an entity's cash runs low.

Any realistic decision-making structure for vacation property needs to account for the possibility that someday the property no longer will be in the family. Perhaps the family cannot afford the property any more. Maybe the family members no longer enjoy the climate, or they identify with some other kind of place. Perhaps there simply is no one left in the family who is interested in the property. When this happens, there needs to be a decision-making vehicle for taking apart the family's interests and dissolving the ownership.

Dispute resolution framework. Yet disputes are far more common than shutting down the enterprise altogether. And seldom does just one dispute turn into total estrangement. More commonly, family members will bicker and then move on, sometimes as though nothing happened. (In such families, this way of handling conflict is part of their natural way of operating.) For this reason the structure must have a well-conceived dispute resolution mechanism.

The dispute resolution system must fit *this family*, not some other family. The family must be made aware of the various dispute resolution procedures—mediation, arbitration, hybrid alternatives, and lawsuits. The family must understand the consequences of judicial partition of a piece of real estate. The family should also appreciate the effect of public disputes on the family's image as well as on the value of the property. And as with any dispute resolution mechanism, the cost of resolving the dispute should be allocated in a way that corresponds to the nature of the dispute.

When it matters even more—other family enterprises

The above discussion provides ample reason to provide a family vacation property its own governance structure. Yet there is more. If the family also owns other significant assets in common—an operating business, an intergenerational investment entity, a set of operating businesses, and investments owned by a parent holding company—all the more should the vacation property have its own governance structure. Just as a vacation property has a phenomenological character that grounds family members in a physical place, so too does an operating business ground family members who work in the business.

Arguably the two settings ground a person in complementary ways. For this reason, if family members experience unnecessary upheaval in decision-making about their vacation property, the upheaval likely will have even more unnecessary, bad consequences in how they make decisions together in their business. Because for-profit activity is what generates the cash to buy and maintain a vacation property, damage to decision-making in the one setting will boomerang back and damage decision-making in the other setting. A good decision-making structure gets rid of this boomerang effect.

Conclusion

Family vacation property deserves its own governance structure, and one that fits the family that uses the property. This kind of governance structure is good in itself, for it clarifies the family's relationship to the place where the property is located, and it helps ground the family's experience of both leisure and work. And if the same family also is involved together in for-profit enterprises, the governance structure for the vacation property will strengthen the family's prospects for success in its for-profit work. Ultimately the family is better off. ■