*Welcome to*

# Utilizing Today's Real Estate Market to Increase Your Wealth

*Presented by*

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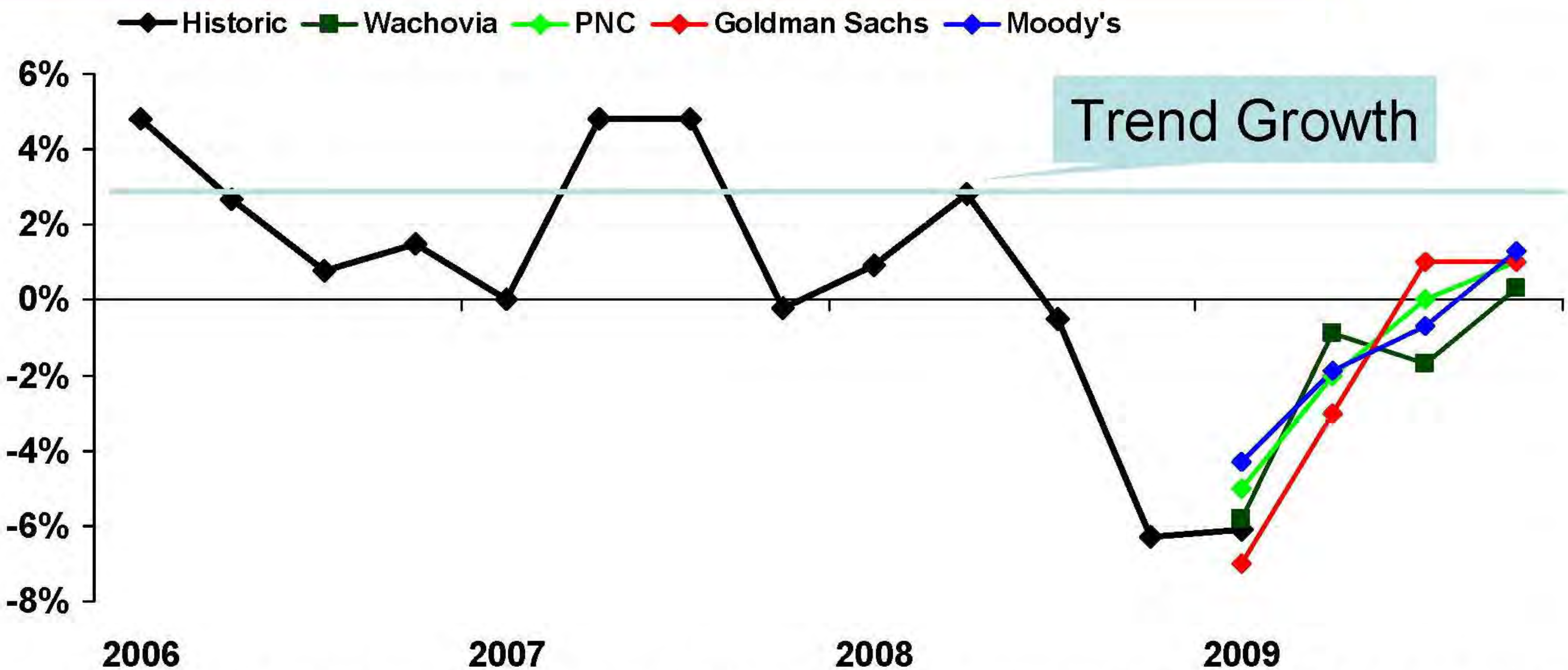
# Gross Domestic Product (GDP), Historic & Forecast

*Annualized Percent Change*

GRUBB & ELLIS.
BRE Commercial

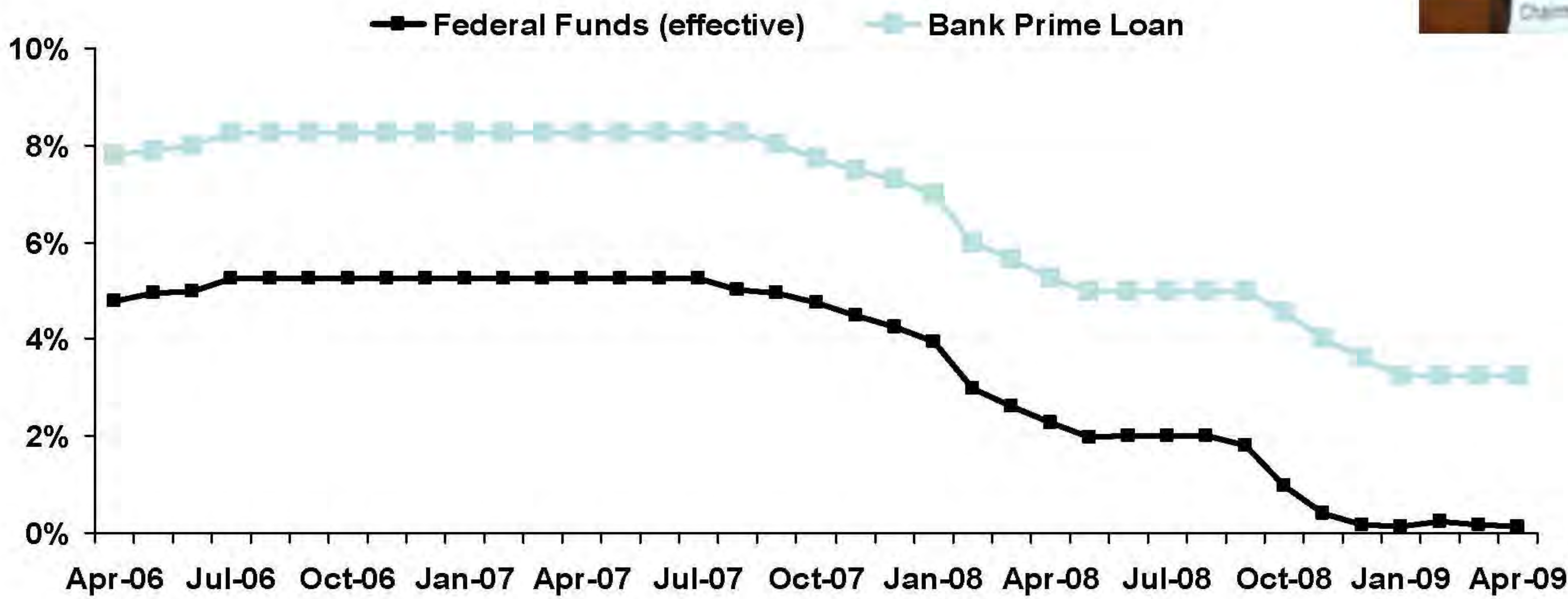



GDP measures how fast or slow the economy is growing. If GDP isn't growing, companies will not need office or industrial space; retailers will not need to expand; and apartment renters may find roommates or move home with mom and dad to conserve cash. GDP increases of 3.0 to 3.5 percent are desirable and sustainable. Faster growth can provoke the Fed into raising interest rates to combat inflation, while GDP increases below 1 percent or so encourage the Fed to lower interest rates to stimulate the economy. Real GDP fell 6.1percent at an annualized rate in the first quarter of 2009, according to the advance estimate, much larger than the consensus expectation for a 5 percent contraction. This followed a decline of 6.3 percent in the fourth quarter of 2008. Consumer spending saw a small increase in the quarter, but other components were decidedly negative, including a big drop in inventories. The personal consumption expenditures price index—the Federal Reserve's preferred inflation measure—rose 1.5 percent at an annualized rate in the first quarter. The economy is in the middle of what will end up being the worst U.S. recession since the Great Depression.

Source: U.S. Bureau of Economic Analysis; National Bureau of Economic Research

Next release date: 5/29/2009

# Federal Funds and Bank Prime Loan Rate

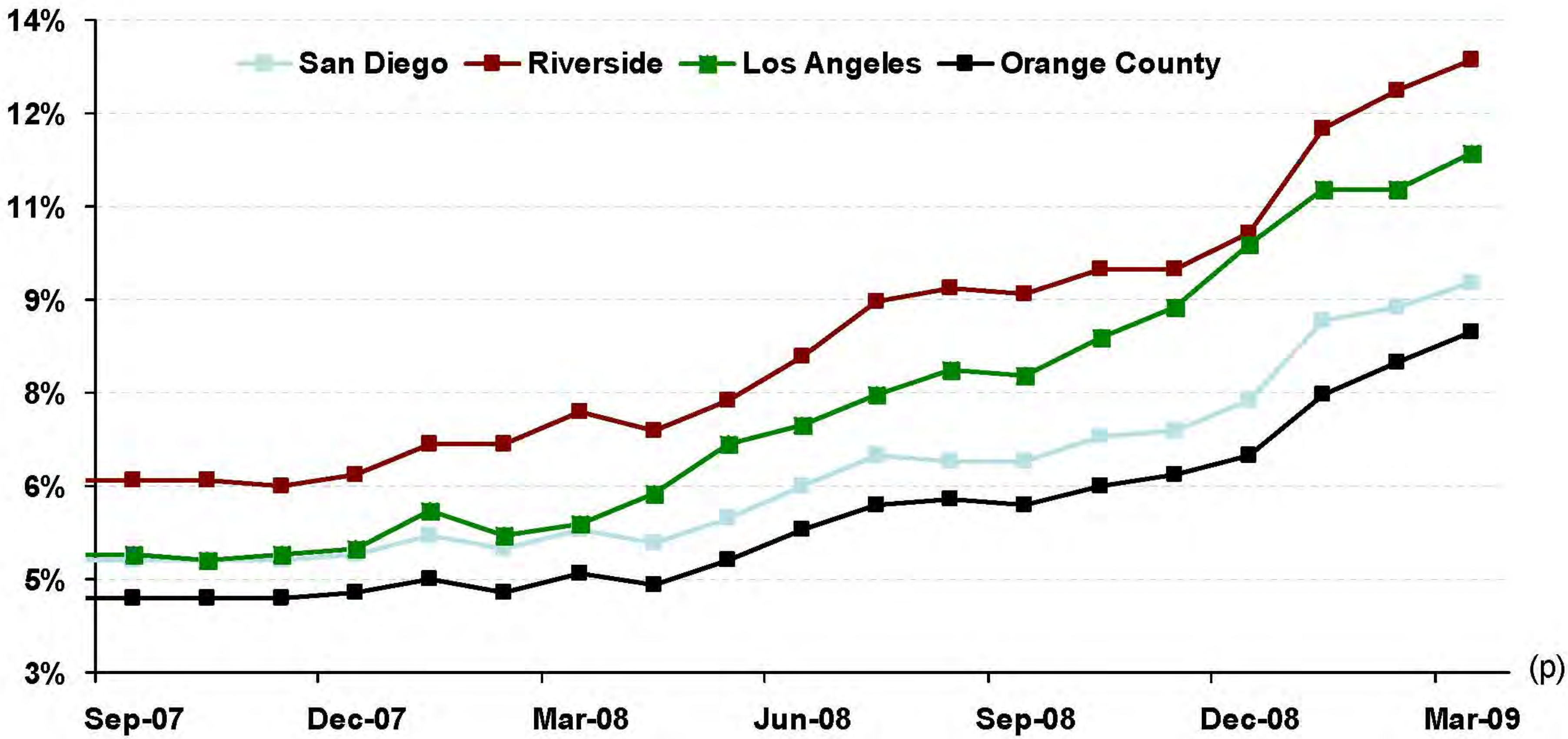

"Information received since the Federal Open Market Committee met in March indicates that the economy has continued to contract, though the pace of contraction appears to be somewhat slower. Household spending has shown signs of stabilizing but remains constrained by ongoing job losses, lower housing wealth, and tight credit. Weak sales prospects and difficulties in obtaining credit have led businesses to cut back on inventories, fixed investment, and staffing. Although the economic outlook has improved modestly since the March meeting, partly reflecting some easing of financial market conditions, economic activity is likely to remain weak for a time. Nonetheless, the Committee continues to anticipate that policy actions to stabilize financial markets and institutions, fiscal and monetary stimulus, and market forces will contribute to a gradual resumption of sustainable economic growth in a context of price stability. In these circumstances, the Federal Reserve will employ all available tools to promote economic recovery and to preserve price stability. The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and anticipates that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period."

Source: Federal Reserve Bank: Board of Governors of the Federal Reserve System

Next release date: 6/23/2009

# San Diego's Unemployment Rate in Comparison

GRUBB & ELLIS
BRE Commercial

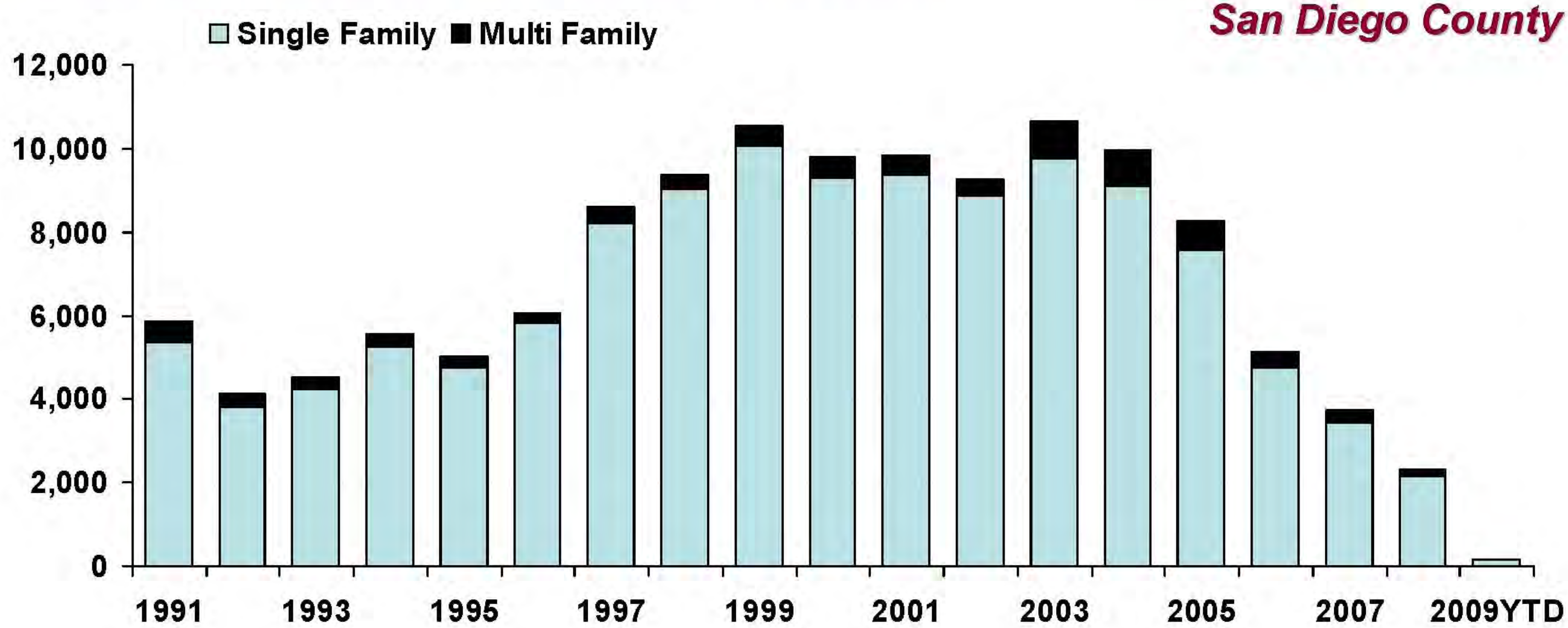



The unemployment rate in San Diego County was 9.3 percent in March 2009, up from a revised 8.9 percent in February 2009, and above last year's estimate of 5.2 percent. This compares with an unadjusted unemployment rate of 11.5 percent for California and 9.0 percent for the nation during the same period.

2009 March Preliminary; Not Seasonally Adjusted
Source: U.S. Department of Labor, Bureau of Labor Statistics
Next release date: 5/22/2009 8:30 A.M. (EST)

# Privately-Owned Building Permits

## San Diego County



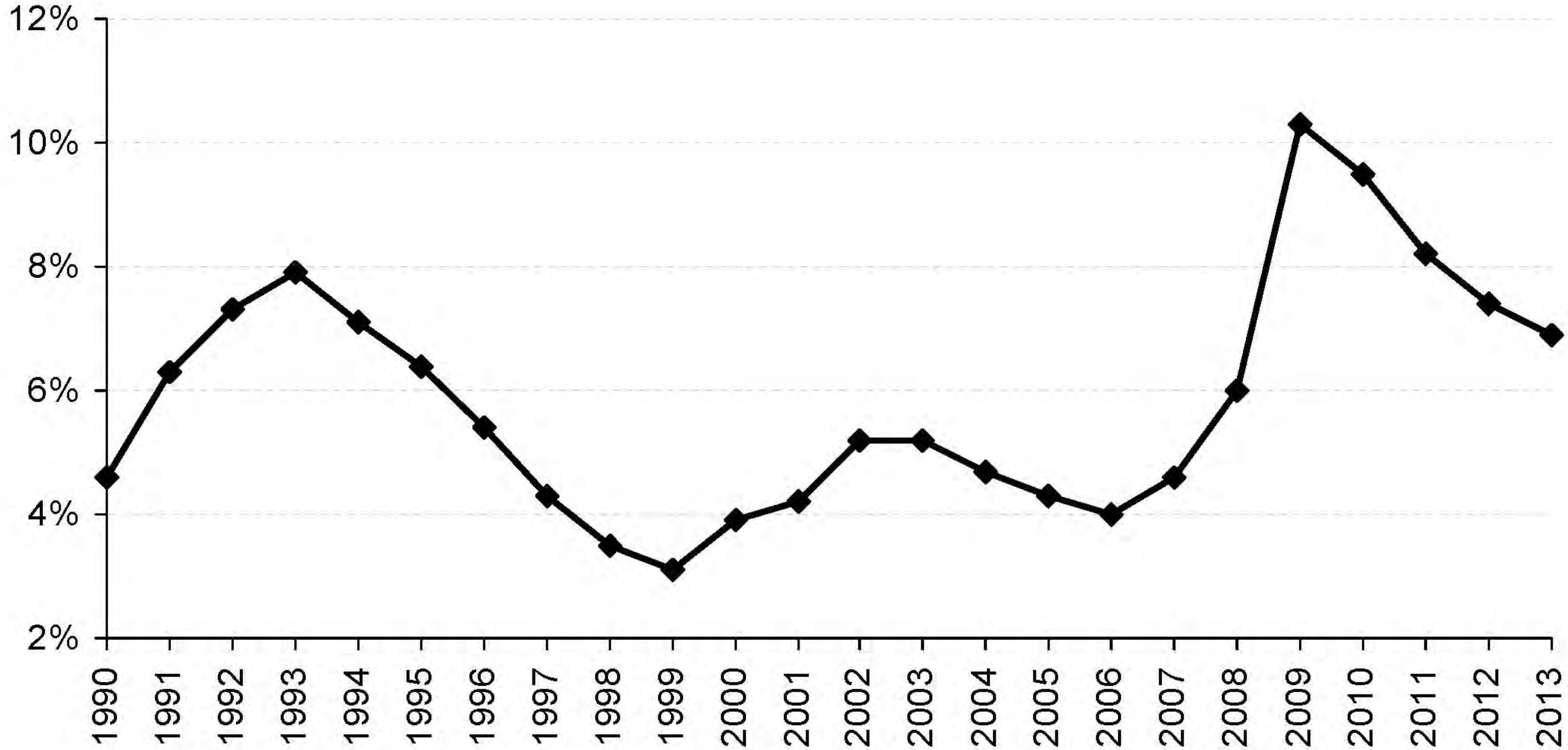

By tracking the issuance of permits, one can get a sense of how much and where future construction activity will take place. The building of single-family homes is by far the largest component of the three (single family, residences with two to four apartments or units and structures with five or more units) accounting for 75 percent of total home building. In February 2009, a total of 81 new privately-owned residential building permits - **single family and multi family** - were issued in San Diego County compared to 152 permits issued in February 2008. Year-to-date as of February 2009, a total of 168 new privately-owned residential building permits were issued in San Diego County compared to 344 permits issued in January and February of 2008.

**Annual New Privately-Owned Residential Building Permits**
2009YTD as of February 2009 Source: U.S. Census Bureau
Next release date: 5/27/2009 8:30 A.M. (EST)

# Unemployment Rate

GRUBB & ELLIS
BRE Commercial

***San Diego County***



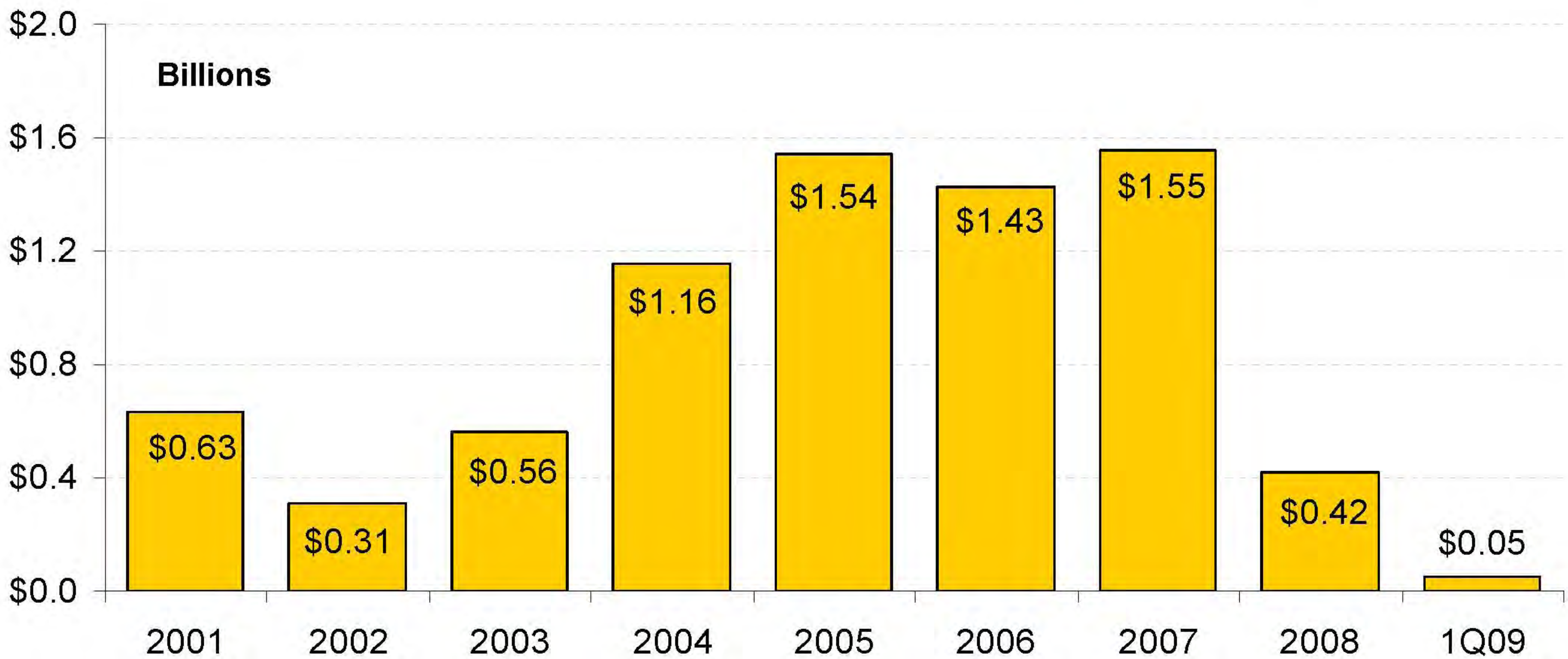

Source: U.S. Department of Labor, Bureau of Labor Statistics for 1990 - 2008
UCLA Anderson Forecast, May 2009 for 2009 – 2013

# Industrial Sales Volume

*$5 Million and Greater*

GRUBB & ELLIS.
BRE Commercial

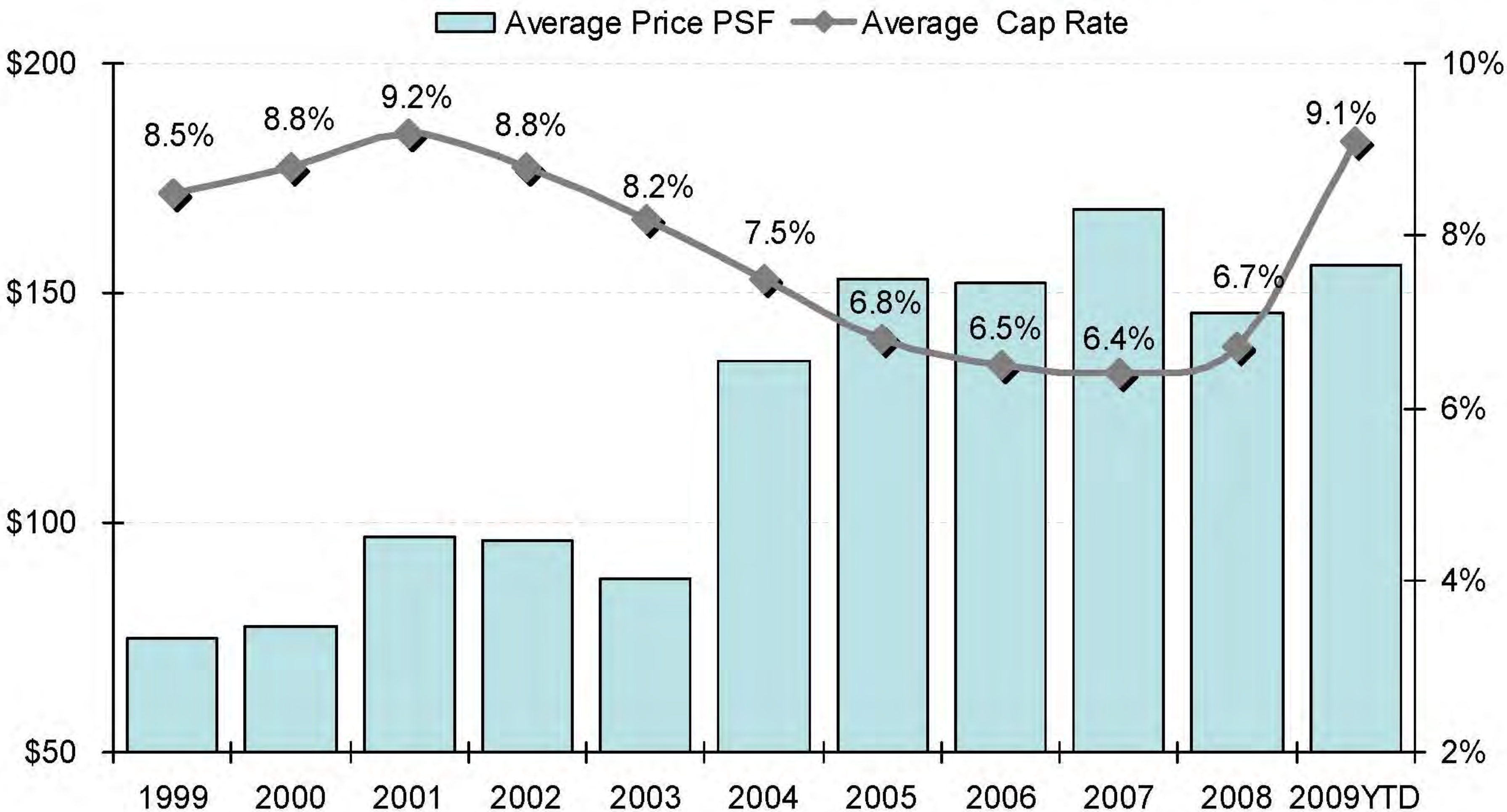
## San Diego County *Industrial*




Source: Real Capital Analytics
Based on independent reports of properties and portfolios $5 million and greater.

# Average Price PSF and Cap Rate

## San Diego County *Industrial*

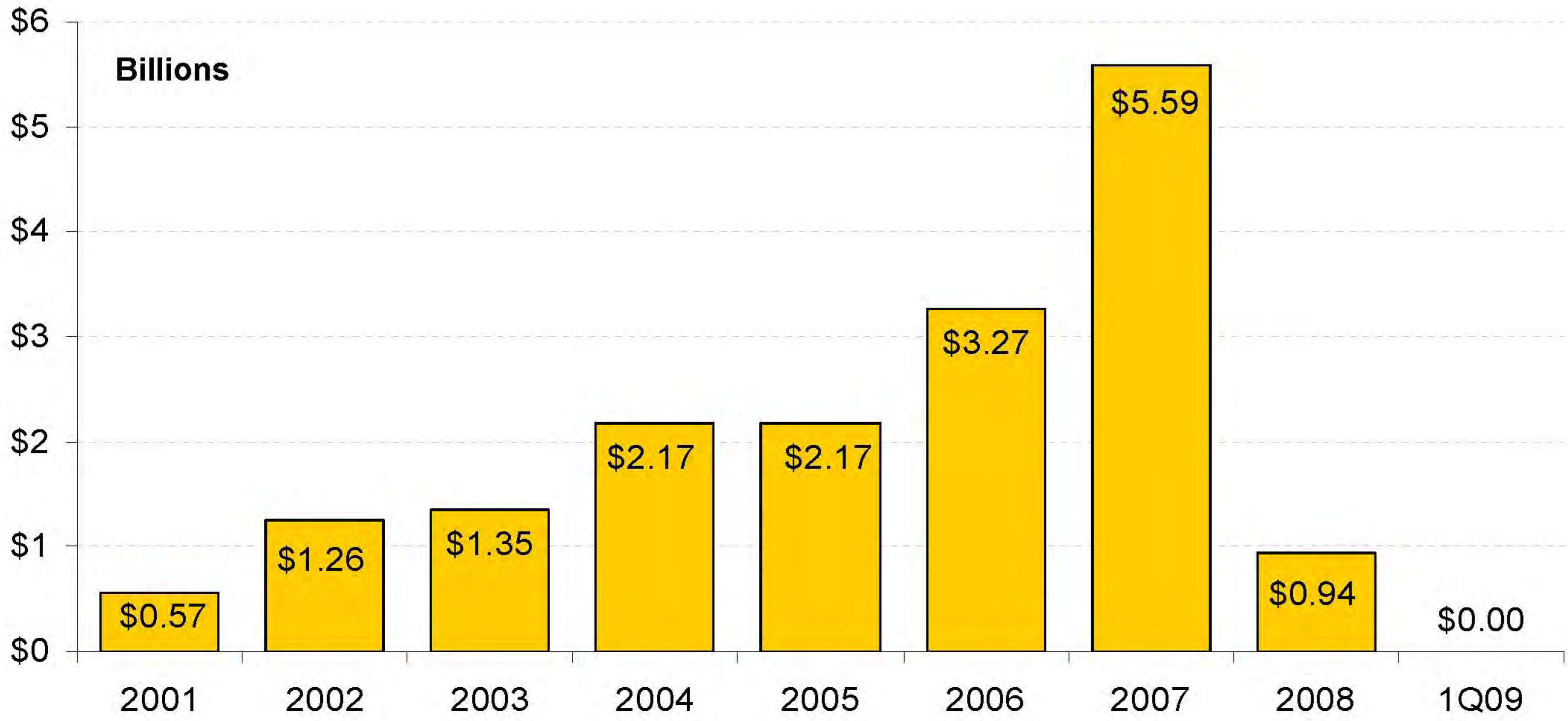



**Industrial & Flex Property Sales in San Diego County – All Sizes**
2009 YTD as of 5/11/2009 Source: CoStar

# Office Sales Volume

*$5 Million and Greater*

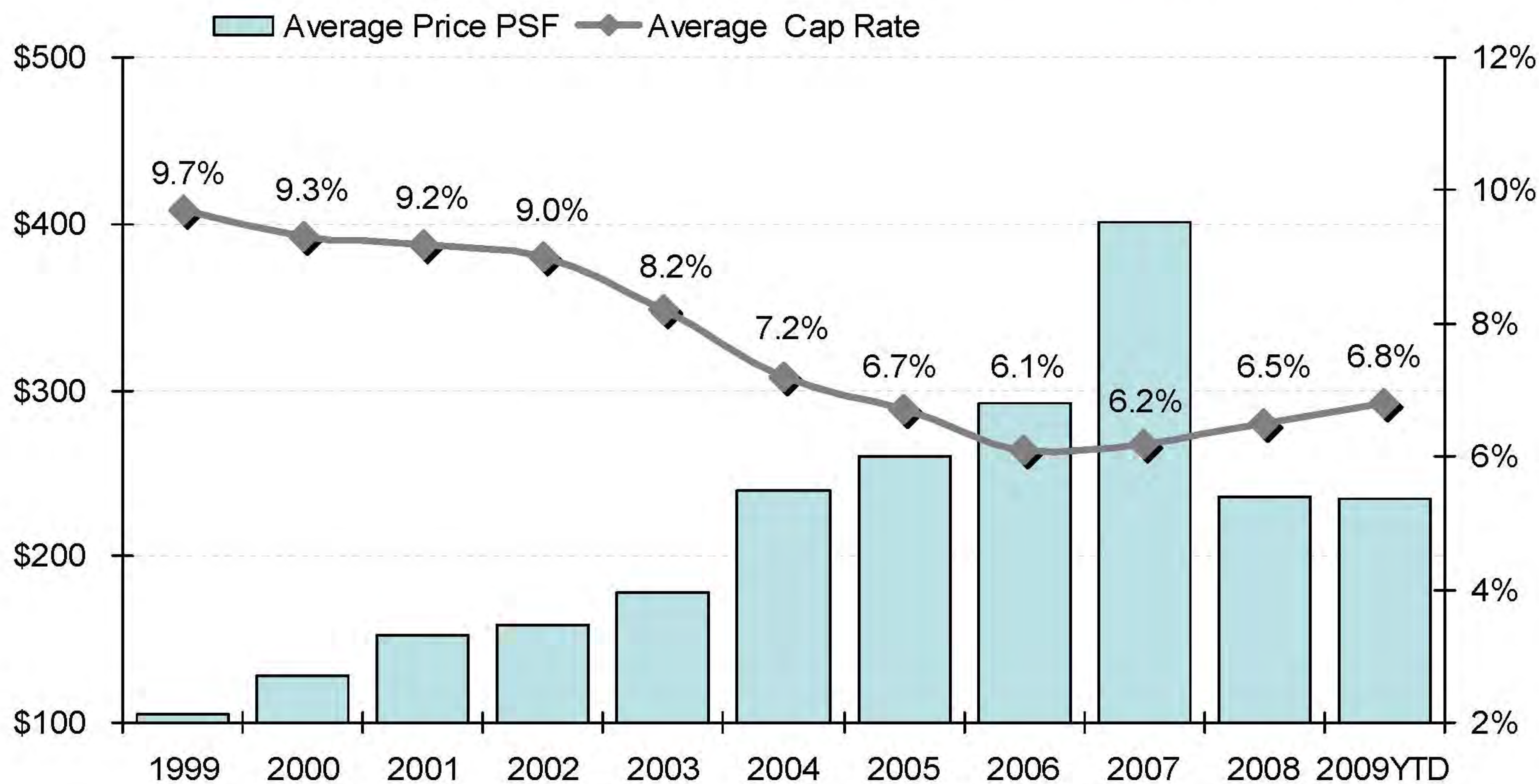
## San Diego County Office




Source: Real Capital Analytics
Based on independent reports of properties and portfolios $5 million and greater.

# Average Price PSF and Cap Rate

## *San Diego County Office*




**Office Property Sales in San Diego County – All Sizes**

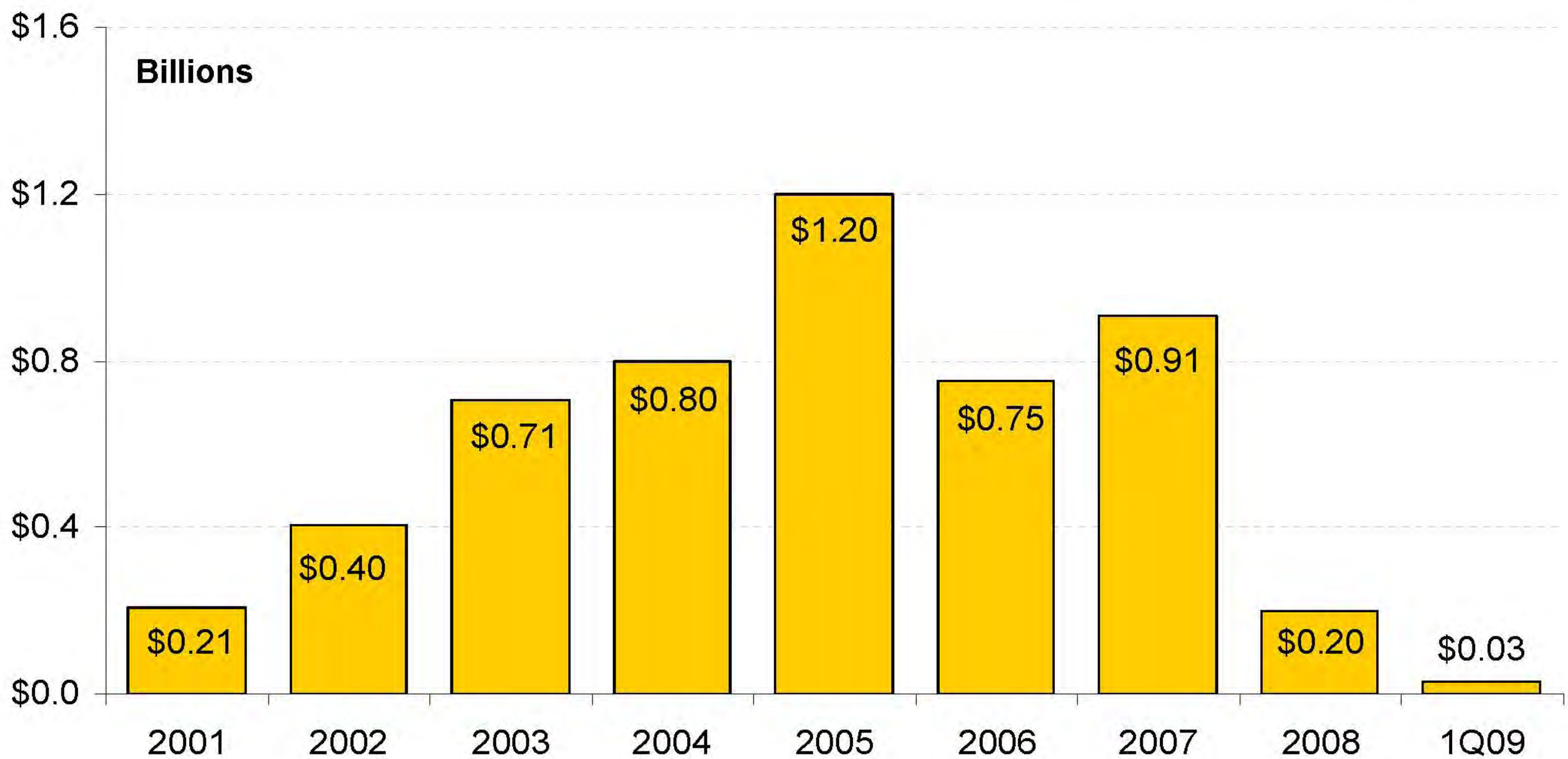
2009 YTD as of 5/11/2009 Source: CoStar

# Retail Sales Volume

*$5 Million and Greater*

GRUBB & ELLIS.
BRE Commercial

## San Diego County Retail

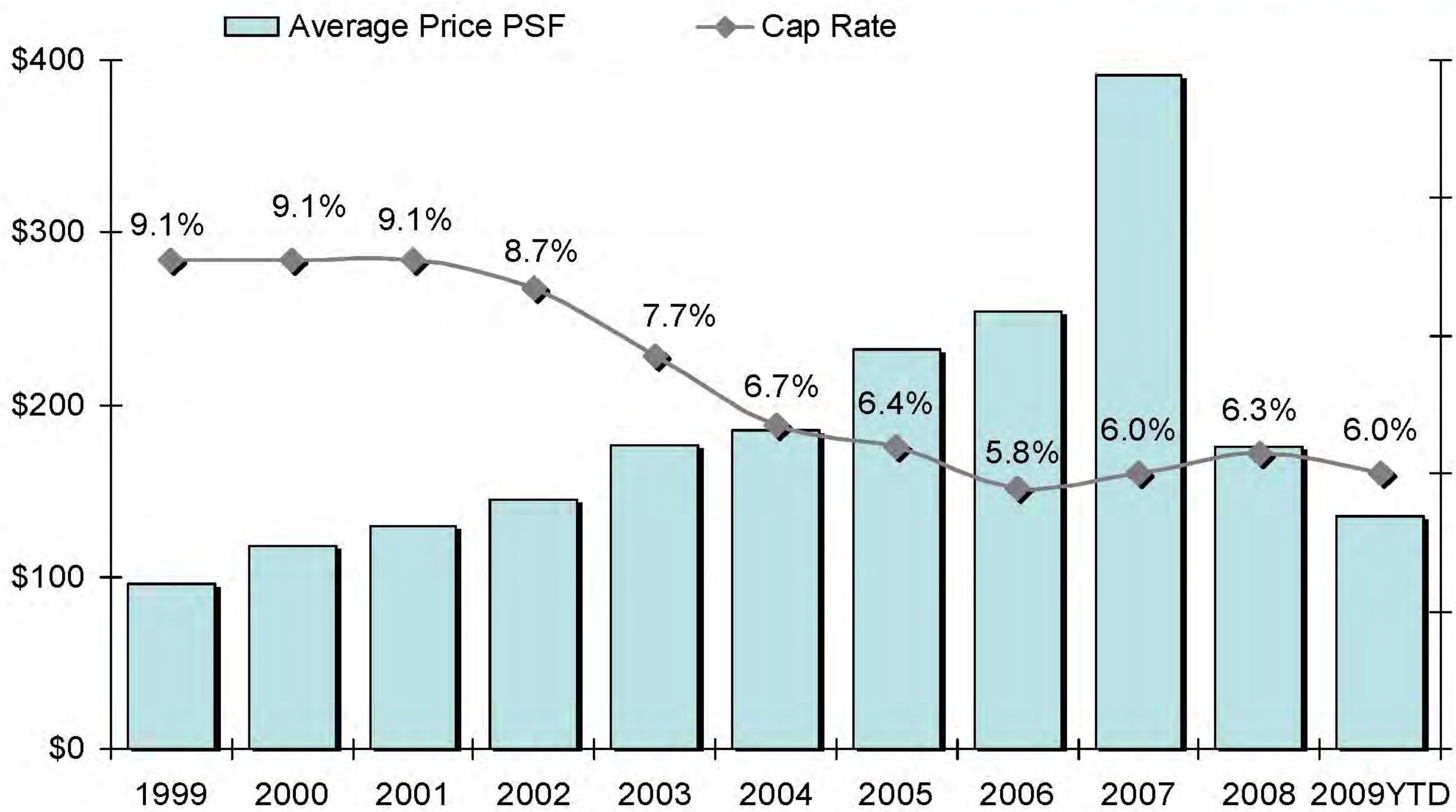



Source: Real Capital Analytics
Based on independent reports of properties and portfolios $5 million and greater.

# Average Price PSF and Cap Rate

GRUBB & ELLIS.
BRE Commercial

## *San Diego County Retail*




**Retail, Shopping Center and Specialty Retail Property Sales in San Diego County – All Sizes**

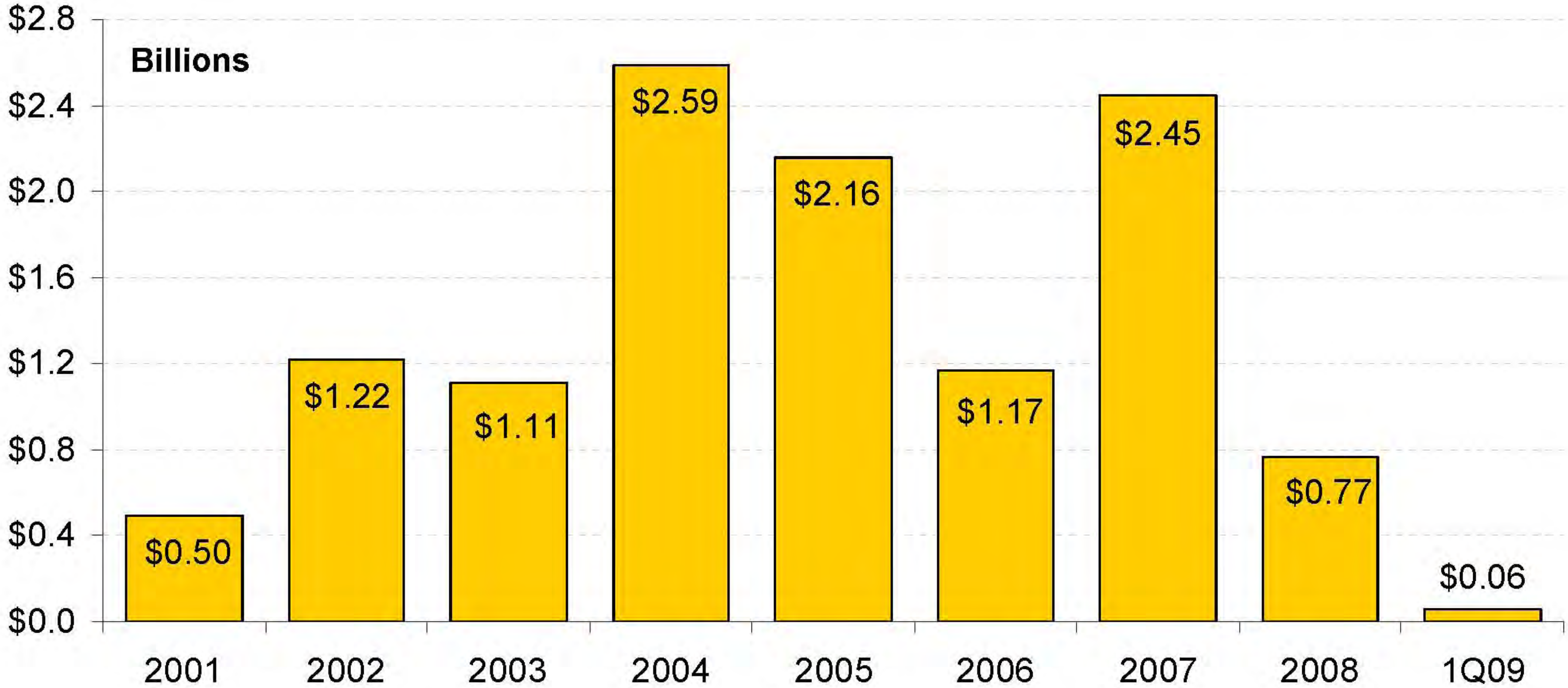
2009 YTD as of 5/11/2009 Source: CoStar

# Multi-Family Sales Volume

*$5 Million and Greater*

GRUBB & ELLIS.
BRE Commercial

## San Diego County *Multi-Family*

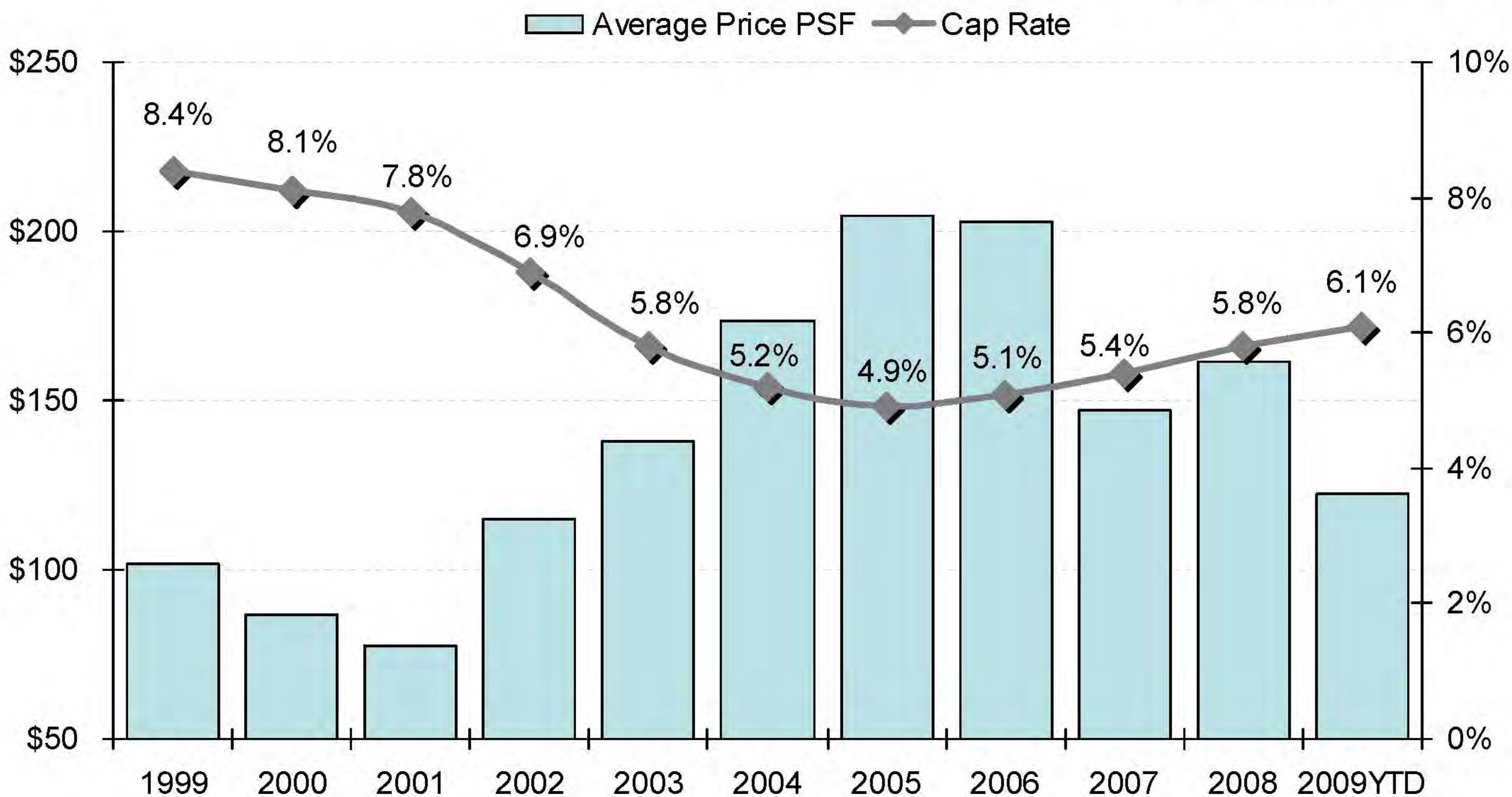



Source: Real Capital Analytics
Based on independent reports of properties and portfolios $5 million and greater.

# Average Price PSF and Cap Rate

GRUBB & ELLIS. BRE Commercial

## San Diego County *Multi-Family*




**All Multi-Family Property Sales in San Diego County – All Sizes**

2009 YTD as of 5/11/2009 Source: CoStar

# Interfamily Loans and Sales

- Current borrowing rates are highly advantageous for interfamily transfers

- Applicable Federal Rates are at historic lows, even with slight uptrend since February of this year

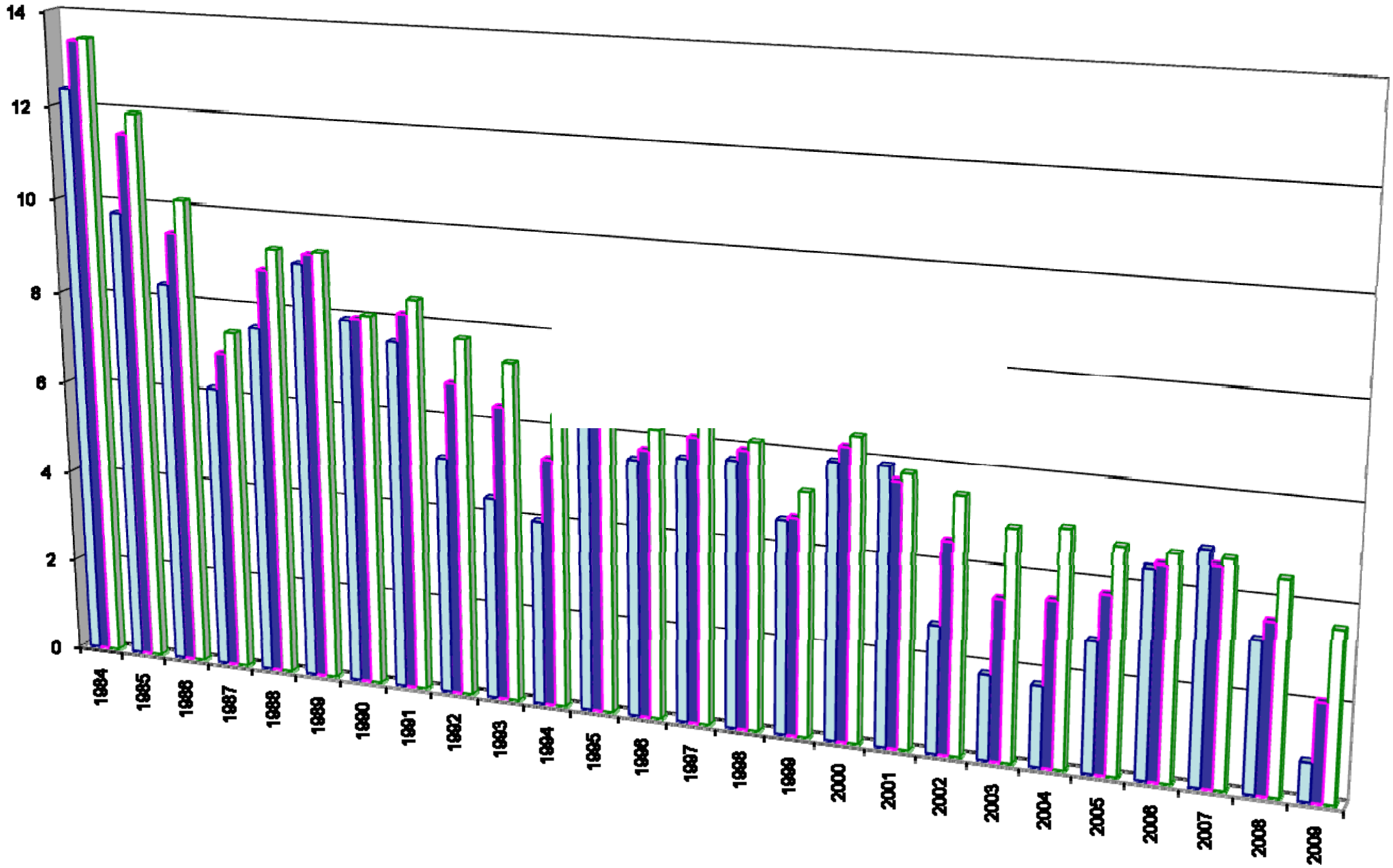
- 15-year comparison of Applicable Federal Rates (AFR)

  1985: Short [9.79%] Mid [11.48%] Long [11.92%]

  2009: Short [0.81%] Mid [2.06%] Long [3.57%]

- ***Midterm AFR February-1.98%, June- 2.71%***

# AFR Rates – 1984 to Present



# Estate Tax Reform-Current Proposals

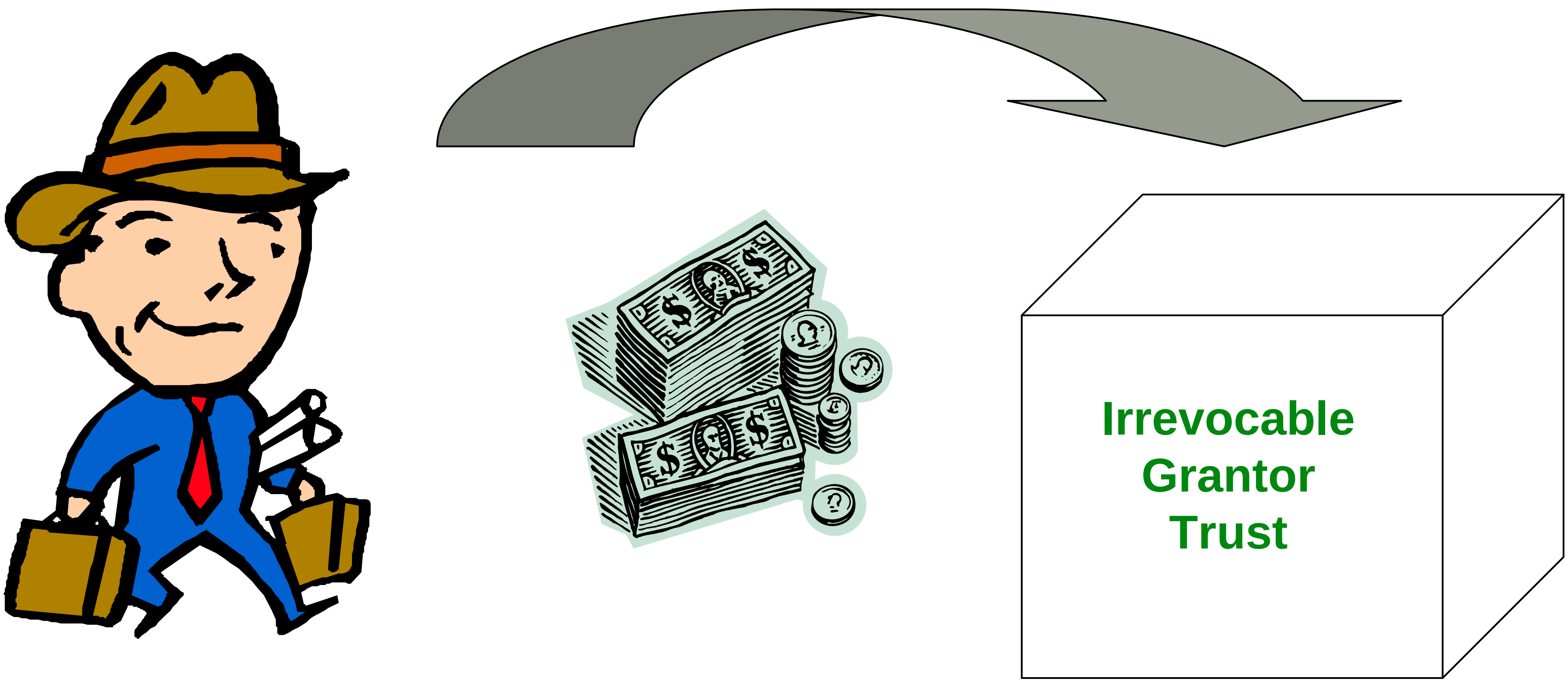
- Current estate tax proposal sponsored by Baucus and supported by Schumer and Rockefeller sets the exemption at $3.5 million per person and index it for inflation with the maximum bracket being 45%. The gift and estate exemptions are to be unified and the income tax brackets up to 28% will be made permanent.
- What is missing is any mention of high net income and high net worth individuals and families.
- Another proposal HR 836 sets exemptions similarly but also threaten discounts. The bill promotes disallowing discounts for anything other than minority interests. Lack of control, and other discounts that are commonly used in Family Business Entities (FLPs, LLCs, etc.)

# Strategies that Protect Wealth

- Administration tax policy does not favor high net worth individuals, families.
- Taxes and rates are likely to be higher in the future.
- Utilizing Strategies that reduce or “freeze” estate value, and will help the family by positioning so as to minimize the effects of inflation and transfer wealth at historically low values.
- ***Tools: Grantor Trusts, Family Business Entities (FLPs, LLCs, Corporations) utilized together to leverage their efficiency.***

# Grantor Trusts- Overview

Client creates and funds an
Irrevocable Grantor Trust for benefit of
Children and Grandchildren



# Grantor Trust-Overview

1. An irrevocable trust whose *assets* are not included in Client's estate

2. Whose *income* is considered taxable to Client even though income remains in trust and is used for other beneficiaries

3. Can be a Generation Skipping Trust, can be a spendthrift trust, can be a "family bank"

4. Trust creators determine terms of trust and determine *"who gets what, and when"*

# Family Business Entities- LLC Example

A *Limited Liability Company (LLC)* is an organization of two or more individuals.

An LLC typically has at least one Managing Member and one Non-Managing Member.

The Managing Member manages the activities of the LLC, and assumes responsibility for its activities.  Non-Managing Members are passive investors with equity ownership, but restricted rights.

# Limited Liability Company – Overview

## Managing Member

1. Controls the LLC
   - Day to day operations
   - Financial decisions
   - Determines distributions
2. Minimal equity interest (1-2%)

## Non-Managing Member

1. Has most of equity interest (80-99%)
2. Entitled to pro-rata distributions
3. Limited voice in management

# Discounting Factors

- Lack of Marketability
- Lack of Control
- Illiquidity of Underlying Assets
- Industry/Peer Group Values
- Geographic/Environmental Issues
- Barriers to entry in industry/location
- ***Economic downturn has led to increased discounts due to uncertainty (i.e.- loss of anchor tenant, likelihood rents will be renegotiated)***
- ***Downturn, Discounts and low rates create opportunities for wealth transfer***

# Limited Liability Company- Discounting Example

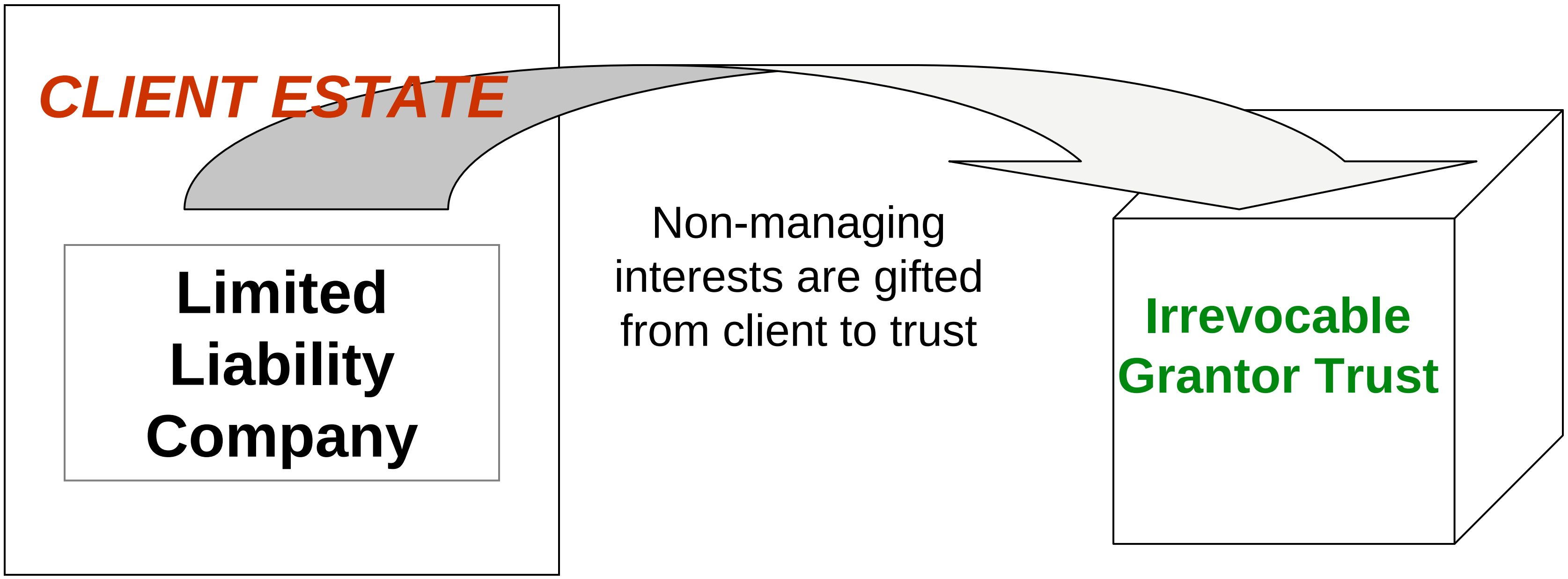
| MANAGING MEMBERS | NON-MANAGING MEMBERS |
|---|---|
| ***$100,000*** | ***$3,000,000*** |

***TRANSFER OF NON-MANGING INTERESTS WILL GIVE RISE TO DISCOUNTS***

***<u>FEWER RIGHTS = DEEPER DISCOUNTS</u>***

| | |
|---|---|
| **$3,000,000** | **VALUE OF LLC ASSETS** |
| **<u>($1,000,000)</u>** | **COMBINED DISCOUNT** |
| ***$2,000,000*** | ***VALUE OF TRANSFER*** |

# Limited Liability Company- Ownership vs. Control




*Client transfers Non-Managing shares to the trust.*
*Client retains control of the LLC as Managing Member.*
*Trust now has ownership position as Non-Managing Member.*
*Transfer tax exemptions should be applied to this transfer.*

# Limited Liability Company- Future Growth

## In 15 Years @ 5% Growth:

| Managing interests<br>***$200,000*** | Non-Managing interests owned by Irrevocable Grantor Trust<br>***$6,000,000*** |
|---|---|
| **Estate Taxes Due @ 45%** | **All post-transfer appreciation is Estate Tax-Free** |

# Discounting Enhances Cash Flow…..

- Discounting asset does not discount cash flow.
- An asset worth 3mil @ 8% turns into 2mil @ 12%
- With low AFR Rates, a family can transfer an asset via sale to a grantor trust and take back a note for close to 2%.
- Under the above assumed facts, the beneficiaries of the trust net 10% income tax free that can be used to pay down the note, leverage into other assets or acquire life insurance for estate liquidity.
- As asset appreciates, all appreciation occurs outside the estate of the senior generation. The note is “frozen” in value and remains at par or is reduced by prepayment.
- Even if discount is challenged/disallowed 8% minus 2% still gives the trust 6% net income

# Estate Freeze Overview

- Estate Freezes create opportunities to shift appreciation to future generations.
- Self Cancelling Installment Notes (SCIN)-Used for older persons or those “actuarially challenged”
- Grantor Retained Annuity Trusts (GRAT)-Think Wal-Mart
- Charitable Lead Annuity Trusts (CLAT) – Combines charitable intent with discounted wealth transfer.

- ***Estate Freezes involve using a Family Business Entity (FLP, LLC, Corporation), a Grantor Trust and one or more of the above to reduce values then “freeze” what remains in the estate.***

# Estate Freeze Overview

Estate Freeze techniques focus on removing appreciating assets from the taxable estate.  Estate Freezes are most common in situations where an individual has made full use of his/her transfer tax exemptions, and is desirous of transferring additional assets to non-charitable beneficiaries without incurring transfer taxes.

***The most common Estate Freeze technique utilizes an LLC, a Grantor Trust, and involves the Grantor selling assets (often Non-Managing shares) to the trust in exchange for an installment note.***

Over time, all growth and appreciation on the assets sold occurs within the transfer tax-friendly environment of the trust, whereas the value of the note remains constant, thus “freezing” its value within the taxable estate.

# Estate Freeze Overview (cont.)

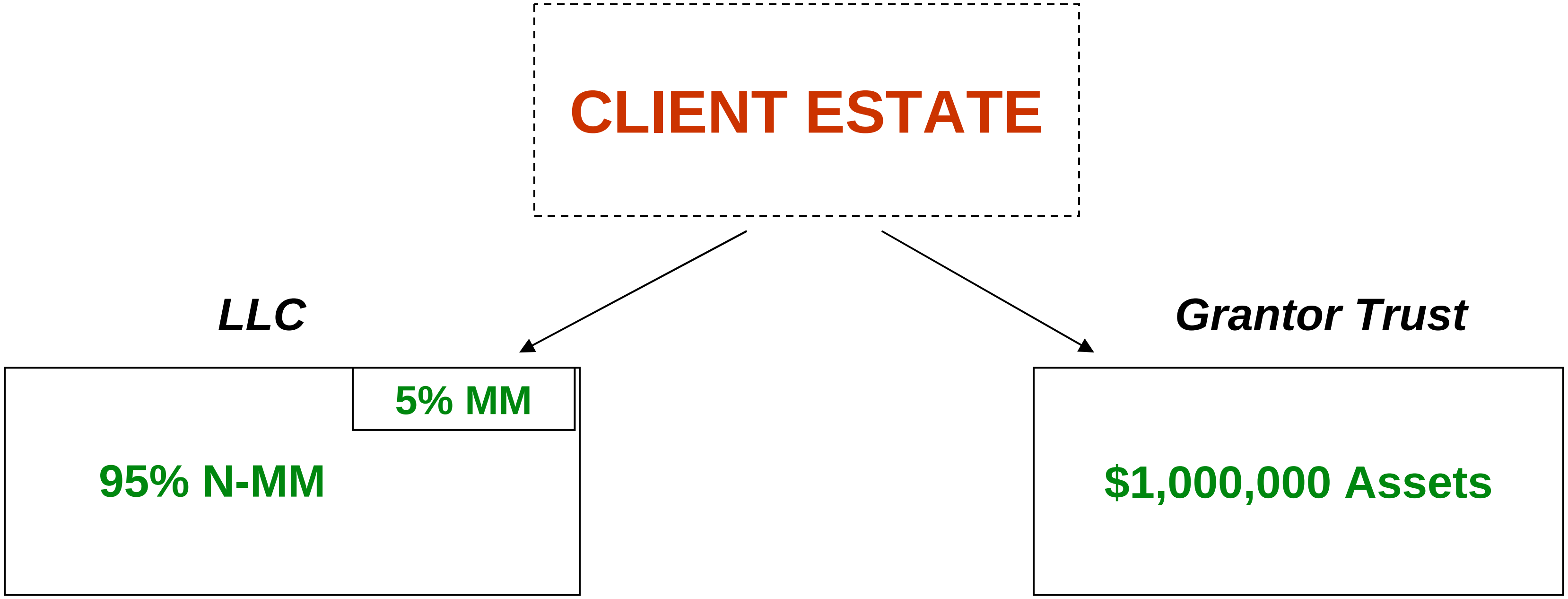
Each year, the trust earns a return based on its ownership of the asset transferred to it.

The trust is required to make interest payments to the holder of the note based on the applicable federal rate (AFR) for inter-family transactions.

All trust earnings in excess of the amount required to pay the note may be reinvested in new opportunities, be leveraged through the purchase of life insurance, or distributed to trust beneficiaries.

***So long as the money that "seeded" the trust was exempt from transfer taxes, all of the "harvest" will be transfer tax-exempt as well.***

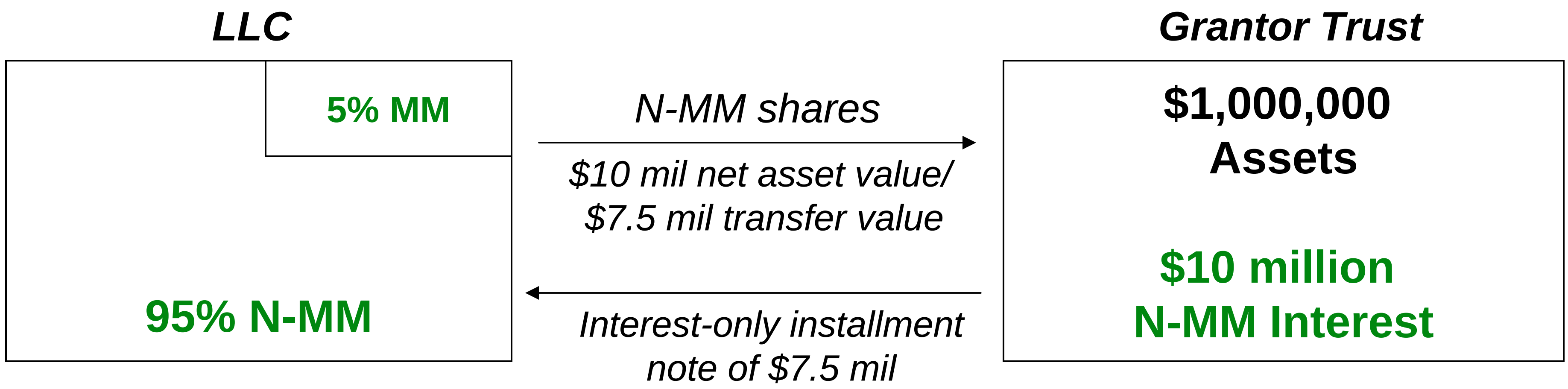
# Estate Freeze- HYPOTHETICAL Step #1




Transfer $10.5 million of assets into the LLC. This is a non-taxable transfer, as client owns 100% of the LLC. The LLC is capitalized as 5% MM and 95% N-MM.

Gift $1,000,000 of assets to the Grantor Trust. Allocate unified credit. Allocate GSTT exemption so that all future appreciation within trust is transfer tax-exempt.

# Estate Freeze- HYPOTHETICAL Step #2




N-MM shares are sold to Grantor Trust at discounted value (25% assumed) in exchange for an installment note.

The note interest is payable at the government rate (currently 2.71% for mid-term note) and represents tax-free income to client.

Trust buys life insurance to insure the note value using trust earnings.

# Opportunities Created

- Reinvestment in tax favored environment
- Assets protected for future generations.
- Excess cash flow can fund insurance purchase without transfer tax consequences or use of annual gifts
- “Opportunity Shifting”
- Creates Family Bank that can be used to fund acquisitions in a protected environment

# Life Insurance for Estate Liquidity

- Survivorship policy-Pays at second death when estate taxes are due. Can be funded with annual gifts, lifetime exemption. When using an estate freeze, income within the trust can be used to fund life insurance without gift or estate tax consequences.
- Credit Ratings of Carrier-Price is not the only concern, and current financial downturn means look at carrier ratings closely.
- Product Design-Funding can be creative to match cash flow of entity. Flexibility is key.
- Premium Financing- Can be useful but watch out!!
- IRR of death benefit drives the concept. If the IRR isn't good then insurance shouldn’t be used.

# Estate Tax Deferral Under I.R.C. 6166

- If the value of a family business in an estate is more than 35%, estate taxes can be deferred over a 15 year period. A down payment is required, and interest must be paid.
- If an estate qualifies for deferral under section 6166, then a court case “Estate of Graegin” allows certain estates to borrow to pay the estate tax and deduct all of the interest over the life of the loan on the estate tax return. Borrowing can be commercial or interfamily.
- Must be arms length, no prepayment, and reasonable chance that note will be repaid.
- Well designed plan will have the executor of the estate borrow from a friendly entity rather than a commercial bank.

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# Case Study For Estate Freeze

# JOE & JANE RANDOM CURRENT SITUATION

**Wills** **D.P.A.**

**Random Family Trust**

Home

IRA Account

R.E. #1

R.E. #2

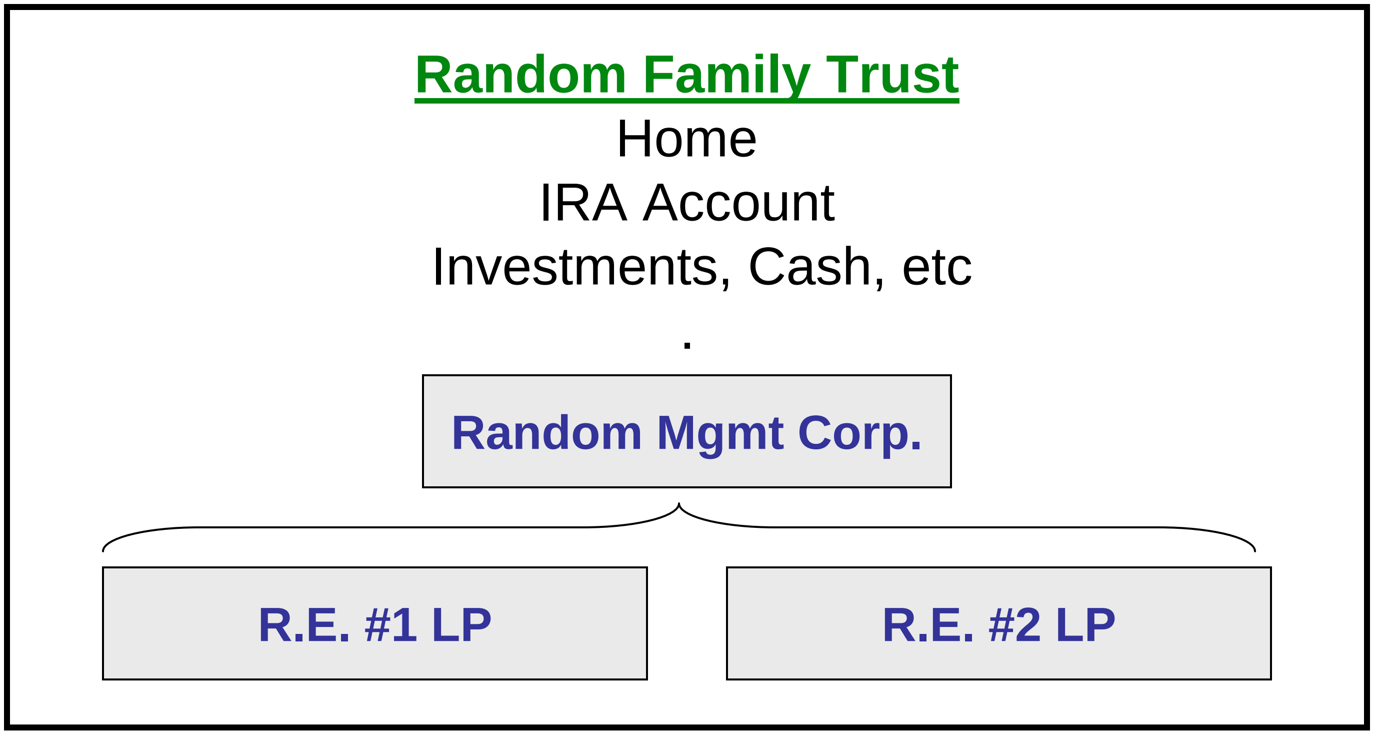
Investments, Cash, etc.

**Annual Income**

| | |
|---|---|
| Gross to JR/JR | $806,315 |
| Federal Tax | $253,335 |
| State Tax | $ 74,704 |
| Net To JR/JR | $478,276 |
| Living Expense | $120,000 |
| Gifting (cash) | $147,000 |
| Available | $211,276 |

- All Assets are currently titled in Random Family Trust
- Joe & Jane are trustees of Random Trust and control operations

# PROPOSED STEP #1




- Personal Residence IRA and Investments remain in the Random Trust as before.
- R.E. #1 & R.E. #2 are placed into Limited Partnerships. Random Management Corp serves as General Partner of both LPs. (see ownership detail next page)

# PROPOSED STEP #2 INITIAL OWNERSHIP

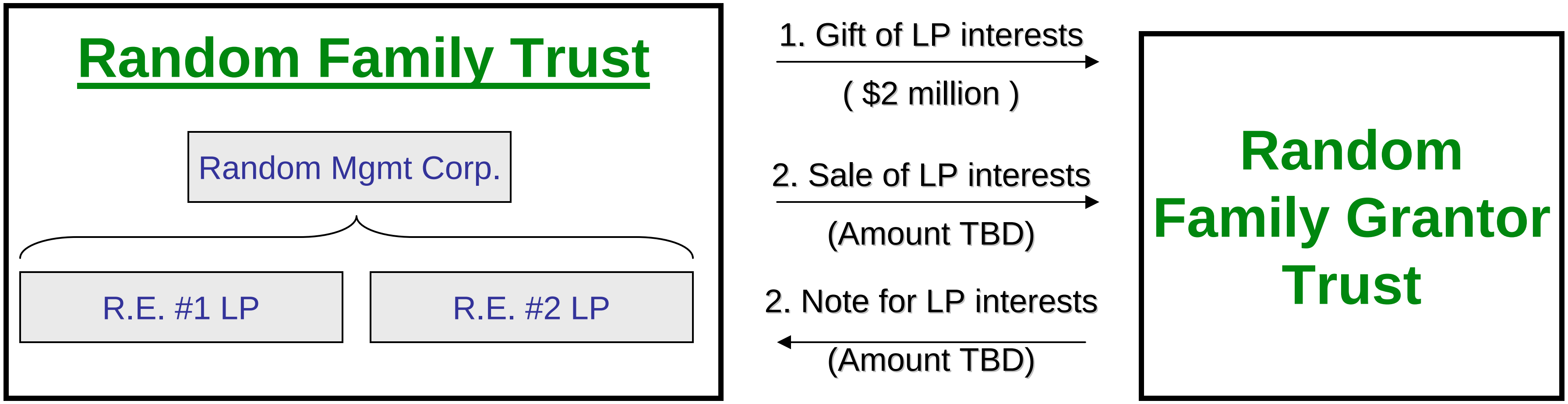
**Random Mgmt Corp.**

50% Random Trust
50% Children

**R.E. #1 LP**
($15 mil NAV)
1% Random Mgmt. Corp. (GP)
99% Random Trust (LP)

**R.E. #2 LP**
($10 mil NAV)
1% Random Mgmt. Corp. (GP)
99% Random Trust (LP)

# PROPOSED STEP #2-THE WEALTH TRANSFER STRUCTURE




- Joe & Jane create Random Family Grantor Trust fbo heirs, and fund it using available lifetime exemptions (currently $1 million each). Gifts should be made using non- voting LP shares. Joe & Jane retain control through Random Mgmt. Corp.
- Joe & Jane sell additional LP units to the trust in exchange for an installment note to remove additional value from the estate.
- All transfers of LP shares will be discounted to reflect the lack of control & marketability inherent with LP shares.  Discounts should be in the range of 35-40%, and will be determined by a specific appraisal.

# PRELIMINARY DISCOUNT ANALYSIS USING R.E. #1

**R. E. #1 LP**
($15 mil NAV)
1% Random Mgmt. Corp. (GP)
99% Random Trust (LP)

**N.A.V. Based On Ownership**

GP= $150,000
LP= $14,850,000/
$9,652,500

- LP shares will be discounted when gifted or sold based on lack of marketability and lack of control.
- Assuming a 35% discount, The LP interests have a N.A.V. of **$14,850,000**, but a Fair Market Value of **$9,652,500**.
- Immediately, **almost $5 million is removed from the taxable estate.**

# PRELIMINARY DISCOUNT ANALYSIS USING R.E. #2

**R. E. #2 LP**
($10 mil NAV)
1% Random Mgmt. Corp. (GP)
99% Random Trust (LP)

**N.A.V. Based On Ownership**

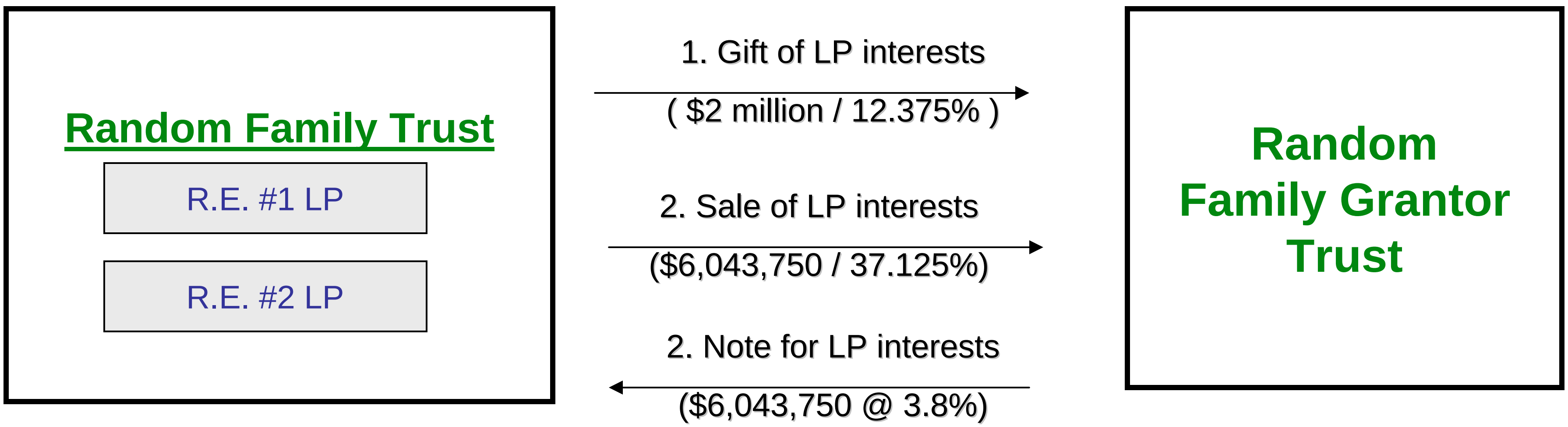
GP= $100,000
LP= $9,900,000/
$6,435,000

- LP shares may be discounted when gifted or sold based on lack of marketability and lack of control.
- Assuming a 35% discount, the LP interests have a N.A.V. of **$9,900,000**, but a Fair Market Value of **$6,435,000**.
- Immediately, **almost $3.5 million is removed from the taxable estate.**

# PROPOSITION 13 ISSUES

- Assuming a 35% discount,  the LP interests of R.E. #1 LP have a N.A.V. of $9,900,000, but a Fair Market Value (FMV) of $6,435,000.  Using the same discount assumptions, the LP interests of R.E. #2 LP have a N.A.V. of $14,850,000, but a FMV of  $9,652,500.
- In California, if you transfer more than 50% of a property, this will trigger a reassessment for property tax purposes.
- If we assume that the total FMV of the LP interests in R.E. #1 & R.E. #2 are worth $16,087,500, then we can only transfer ½ of this value (Total LP interests= 99%, ½ = 49.5%)
- 49.5% of LP interests in R.E. #1 & R.E. #2 = $8,043,750

# MECHANICS OF THE TRANSACTION




- LP interests gifted and sold total 49.5% of the total value, therefore should not trigger reassessment for property tax purposes.
- So long as Generation Skipping Transfer Tax exemption is allocated to the initial gift, all post transfer growth and appreciation is estate tax exempt for multiple generations. Note is payable at government rate for interfamily transactions (currently 3.8%).
- Going forward, all income will be distributed pro rata between entities.

# RESULTS OF THE TRANSACTION- OWNERSHIP

**Random Family Trust**

Home
IRA Account
Investments, Cash, etc.

Random Mgmt Corp.
50%

R.E. #1 LP
49.5%

R.E. #2 LP
49.5% LP

Subject to estate taxes

Not Subject to estate taxes for three generations

**Random Family Grantor Trust**

R.E. #1 LP
49.5%

R.E. #2 LP
49.5% LP

Life Insurance

- After transfer, 49.5% of appreciation of both R.E. #1 & R.E. #2 is outside of estate.
- Each year, Grantor Trust must pay note to Joe & Jane using income received from rents, etc.
- Income in excess of note payment can purchase life insurance without transfer tax costs.

# RESULTS OF THE TRANSACTION- CASH FLOW

**Random Mgmt Corp.**
50% Random Trust
50% Children

**R.E. #1 LP**
($15 mil NAV)
1% Random Mgmt. Corp. (GP)
49.5% Random Trust (LP)
49.5 % Random GT (LP)

**R.E. #2 LP**
($10 mil NAV)
1% Random Mgmt. Corp. (GP)
49.5% Random Trust (LP)
49.5% Random GT (LP)

| | |
|---|---|
| **Total Net Income** | **$806,315** |
| Total to Random Trust (49.5%) | $399,126 |
| Total to Random GT (49.5%) | $399,126* |
| Total to Random Mgmt. (1%) | $ 8,063 |

* **From this amount, a note payment in the amount of $233,400 must be paid to Random Trust each year. This leaves $165,726 to be utilized for life insurance premiums.**

# $64,000 QUESTION- HOW WILL THIS AFFECT MY INCOME?

## Before vs. After

**Annual Income** (Before)

| | |
|---|---|
| Gross to JR/JR | $806,315 |
| Federal Tax | $253,335 |
| State Tax | $ 74,704 |
| Net To JR/JR | $478,276 |
| Living Expense | $120,000 |
| Gifting (cash) | $147,000 |
| Available | $211,276 |

**Annual Income** (After)

| | |
|---|---|
| Gross to JR/JR | $636,557* |
| Federal Tax | $253,335** |
| State Tax | $ 74,704 |
| Net To JR/JR | $308,518 |
| Living Expense | $120,000 |
| Gifting (cash) | $147,000 |
| Available | $ 41,518 |

*This amount includes $399,126 from 49.5% ownership of R.E. #1 &2 LP, $4,031 from 50% ownership of Random Mgmt. Corp (1% GP of both LPs) and $233,400 from the note payment from the Random GT. ($399,126+ $4,031+ $233,400= $636,557)

**JR/JR Taxes remain the same, as you pay income taxes for the Random WT. The note payment back to you is income tax free as the entities are the same for income tax purposes.

# Value Added to Clients

- *Estate Tax Value Frozen at value as of transaction date.*
- *All post Transaction appreciation to heirs in trust that you design, you dictate terms.*
- *Creates Family Bank, and can be used in conjunction with charitable strategies.*
- *Modest impact to clients cash flow. Case design can be driven by cash flow.*
- *Trust owned life insurance funded out of trust income creates fund that can be used for estate tax payment, estate division, or to be used to create a “Graegin” loan.*
- *Because of low AFR, Low values and deeper discounts due to market conditions, now is an ideal time to do estate freeze transactions.*