



## How can I transfer and sell units of my rental real estate LLC?

When it comes to crafting an operating agreement, taking extra time to really iron out the transfer provisions is extremely important. There are of course additional considerations when entering into an operating agreement, some of which we cover in our article: [How do I start a real estate company with a friend? Who makes decisions for my LLC?](#)

Failing to plan ahead when it comes to the transfer of membership units can be incredibly inconvenient for members of the company. These provisions can be overly restrictive and disallow any and all transfers, or, more likely, the provisions do not cover a specific scenario and a transfer is allowed that changes the membership structure of an entity in an undesirable way for one of the members. For example, two members start an LLC and own it 50/50. If there are no restrictions on transfers and one of the members suddenly wants out, he or she can sell his or her units to a willing buyer. Afterward, the LLC would have a new member with one of the old members. Suddenly the original member is forced to operate the company with someone that he or she did not originally set out to do business with.

### **Transferring with an interested buyer**

When it comes to the transfer of units, generally, you can craft the provisions of the operating agreement to require that the other non-transferring members of the LLC consent to any transfer of membership units prior to any such transfer. This can reduce the possibility of a non-transferring member being forced to manage an LLC with an undesirable co-member.

Beyond simply requiring consent, it is not uncommon for the operating agreement to also

contain a right of first refusal when it comes to the transfer of membership units. Let's say that there are two 50/50 members. One of the members wants out and there is a buyer who wants to pay \$100,000 for the units. If the LLC has the right of first refusal with respect to transfers of units, the LLC would have the option to buy the exiting members units for \$100,000. If the LLC does not exercise the right, the sale of the units to the buyer would occur and the ownership structure would be 50/50 between the one original member and the new buyer going forward.



### ***What happens if there is no buyer?***

Even when there is no potential buyer, there can be situations where an existing member simply wants out. You can still include the right of first refusal in such instances, so that the LLC can purchase the units first. In this situation, if there is no identified buyer the LLC is not going to have a specific dollar amount from a third party to base the sale price on. In such an instance, the LLC would purchase back the units at their fair market value. This would include an analysis based on the property's value

and expected rent to be received from the given property, among other things.

### **Transferring without consent**

In addition to requiring consent, you can add in exceptions that allow for a member to transfer his or her units in certain situations without consent. One of the most common reasons is for estate planning purposes. For example, a member might want to transfer his or her units to a trust of which he or she is trustee and still would exercise voting rights for the units transferred to the trust. You should explore how to transfer units as gifts in the operating agreement, as well. This usually includes potential gifts to spouses and other family members. You should discuss this provision with your estate planning attorney to determine whether this seems like something that would be beneficial for you and your overall estate plan.

### ***What happens in the sudden passing or a severe disability of a member?***

Finally, there are several other circumstances that the buy-sell provisions of your operating agreement should cover. In the unfortunate event of the death of a member, or even a severe disability, you need to determine what will happen to that member's units. If you don't plan for this, the deceased member's units are going to pass according to his or her estate plan. Depending on how the deceased member's estate plan is set up, the surviving members could end up operating the company with some other unintended members that such surviving members might not really want to do business with. Again, here it is common to have the LLC have the right of first refusal when it comes to buying the units of the deceased member, with payments going to the deceased member's estate.

When a member suddenly dies, the remaining member of the LLC, or the LLC itself, might not have enough money on hand to purchase the deceased member's units, so it is also common that the LLC purchase life insurance policies on the lives of its members, in amounts roughly equivalent to value of each member's ownership interest. This can be relatively inexpensive and also it will be an expense that the members can deduct from the overall profits of the company anyway. If you do not set this up, and the remaining ownership

does not have the money to purchase the units for their fair market value at the time of death, then the purchaser can purchase the membership units with a promissory note, so as to spread out the payments over time. This is usually a less desirable option, however, since life insurance can be a relatively inexpensive option that allows all of the money to be paid up front, rather than having an ongoing obligation.

As always, each situation is unique, so reach out to an attorney at CPM to discuss your circumstances and the course of action that makes the most sense for you and the real estate you own or plan to own.