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REAL ESTATE JOINT VENTURES/LLC BOOT CAMP FOR SYNDICATORS

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The purpose of a real estate joint venture is for various parties to enter into an arrangement to acquire, develop and operate commercial real property. Joint venture capital may be funded as preferred equity or common equity. Preferred equity may be a favored structure for an investor seeking greater certainty of current profit versus a larger residual interest. The entity is usually structured as a limited liability company or limited partnership.

Joint venture capital structured as common equity could be desirable because with no preference of interests, the members' interests are more aligned. The investors tend to be institutions, e.g., insurance companies, pension funds and their advisers, hedge funds or a variety of accredited investors (as defined in Rule 503 of Regulation D). Typically, the managers are privately owned companies seeking to leverage their capital to many real estate investments. Some managers may be well capitalized and able to contribute up to half the equity, while others need one hundred percent (100%) of the capital for a project.

In most joint venture agreements and/or operating agreements or limited partnership agreements, the following are the most important issues.

1. **Respective Equity Contributions.** Most investors want their operating partners to invest at least five percent (5%) of the equity requirement, and possibly a minimum of ten percent (10%).
2. **Preferred Return to All Investment Capital.** Usually ranges from eight percent (8%) to twelve percent (12%).
3. **Promotes.** A promote (an incentive fee) is a disproportionate share (relative to capital accounts) of cash flow payable to the operating partner after certain return thresholds to the capital accounts are achieved. The documents must be drafted to provide for an acceptable return to the investor prior to the payment of such a fee or an investor will not want to invest in a project.
4. **Fees.** In development transactions, the manager may receive a developer's fee in the range of three percent (3%) of total development costs. Up to half of this fee may be deferred pending completion of the project in cases where the manager is not investing much equity. Some manager entities are willing to forgo the fee until the completion and sale of the project.
5. **Guarantees.** In development projects, most investors require the development partner to provide completion and carve-out guarantees, and the debt is typically non-recourse to all parties.
6. **Governance.** Most institutional investors want final say on major decisions, such as the sale, financing, bankruptcy, annual budgets, major leases, etc. of the project. Disputes may be resolved in various ways, though the most common could be a buy-sell provision. Buy-sell provisions must give the operating partner adequate time to raise the funds necessary to buy out the investor. The investor must have adequate time to prepare for the potential takeover of the

project. Valuation of the interest could be at fair market value, net book value or some other agreed upon calculation.

7. **Sale.** Rights of first offer are often given; rights of refusal are not, due to the negative effect they can have on the marketing process. Tag-along/drag-along rights (i.e., being able to require a full partnership or member interest sale) are less common but still considered.
8. **Claw-back.** Investors are reluctant to pay fees on transaction deals and then have subsequent investments lose money; therefore, they want either to defer some or all of the fee payments or have claw-backs of previously paid fees to achieve a minimum rate of return.
9. **Transaction Costs.** Operating partners want all closing costs – due diligence, legal fees, broker fees, etc. – rolled into the project. Some investors will want each party to pay its own legal fees.
10. **Document Drafting.** Generally, the investor will negotiate the terms of an operating agreement in the case of a limited liability company to be sure that its interests are protected. The manager, or promoter, will prepare the document package for review and negotiation by the major investor.

Structuring joint ventures is more subjective than marketing an asset for sale or financing. Offering materials are usually sent to a few select individuals/entities. Meetings are scheduled at the highest level with appropriate investors. The operating partner is important to the scope of the project. In a sale or financing, the property is underwritten (although lenders are certainly interested in the track record of the borrower); in a joint venture, there is as much due diligence of the operating partner as of the property. In entering into a joint venture, investors and operating partners are hopeful that the first investment together will lead to others, so while the negotiation of terms is not always easy, it must remain reasonable. Operating partners must be sufficiently motivated to work an investment the best they can investors must feel they can trust the operating partner or they will fight every operating partner initiative. It is critical that the documents are drafted to reflect each parties' goals.

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