

ACING IT: Mastering the Nuances of Real Estate Joint Ventures



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Team



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Deal Considerations

- Identity of the parties
- Property Acquisition
- Project Business Terms and Timeline

The Four Fundamental Issues in Every JV Deal

1. Capital Structure ("Money in")
2. Management
3. Cash Distributions ("Money out")
4. Transferability of Interests/Exit Strategies

These 4 items will constitute the central elements of any JV Term Sheet.

Capital Structure

1. Funds necessary to implement the business plan / objectives of the JV will be some combination of equity and debt.
2. Equity refers to the risk capital in the transaction - it is coming out of someone's pocket.
3. In JV setting, equity infusions are referred to as capital contributions.
4. Financing Structure / Guaranties.

Capital Contributions; General

1. Essentially all deals will require some level of "Initial Capital Contributions"
 - a. Cash
 - b. Real Property
 - c. Services

Additional Capital Contributions

1. Which Member may make a call for additional capital?
2. May capital be called for any reason?
3. Who is obligated to fund?

Consequences of Failing to Fund Additional Capital Contributions

Non-Defaulting Member generally has several options, including

1. Member Loan / Company Loan
2. Capital Contribution resulting in dilution of the Defaulting Member's Percentage Interest (punitive vs. straight-line)
3. Company Loan with option to convert to Capital Contribution (resulting in dilution)

Management

A. Project Budget and Business Plan; and Cost Overruns

1. Members will agree on a Project Budget and Business Plan
2. Managing Member will typically be tasked with running the day-to-day management pursuant to the approved Project Budget and Business Plan
3. Competing interests in implementation of Business Plan and Project Budget
4. Cost Overruns - how are they defined and who bears the risk?

Management (cont'd)

B. Major Decisions

1. Almost every Agreement will set forth a list of Major Decisions which will require unanimous (or some lesser defined) consent of the Members
 - a. Managing Member wants broad discretion to implement Business Plan and wants a more limited list
 - b. Capital partner wants to protect its investment and wants an expansive list

Management (cont'd)

- Major Decision Examples
 - Approving a Business Plan and / or Budget
 - Borrowing or lending money
 - Selling substantially all of the assets of the Company
 - Entering into a joint venture or merger
 - Admitting a new member
 - Modifying the purpose of the Company
 - Related party transactions
 - Dilutive effect transactions
 - Any action which could trigger liability under a guaranty or expose a party to personal liability
 - Selection of general contractor, architect and other design professionals

Management (cont'd)

C. Effect of "deadlock" on a Major Decision

1. Sometimes the parties remain deadlocked - "you are big boys / girls, go figure it out"
2. Sometimes the parties will agree to resolve by arbitration - but may limit decisions which may be resolved by arbitration to a subset of entire list of Major Decisions
3. Sometimes may resolve by the trigger of an "exit strategy"
 - i. most frequently, a buy-sell
 - ii. sometimes property put on market for sale to third parties ("forced sale")

Management (cont'd)

D. Removal Provisions Heavily Negotiated

1. Typically solely attributable to "bad acts"
2. Can be expanded to "performance standards"
3. Consequences
4. Release / Replacement of Guaranties

Cash Distributions

"Waterfall"

1. These are the provisions which reflect the "business deal" of the parties - every one is different and is negotiated as central part of the JV
2. Generally (and simply) speaking, will consist of:
 - a. Return on capital (the "preferred return"; similar to interest)
 - b. Return of capital (return of all Capital Contributions; similar to principal repayment)
 - c. Distribution of profits (here is where Promoted Interest come into play)

Transferability of Interests and Exit Strategies

A. In General

The term "Transfer" is typically defined very broadly

Example - "directly or indirectly, assign, sell, exchange, transfer, pledge, encumber, hypothecate or otherwise dispose of all or any part of its Interest, including any non-economic right provided to a Member, or any direct or indirect interest (whether legal or beneficial) in such Member (any direct or indirect assignment, sale, exchange, transfer, pledge, hypothecation or other disposition of a direct or indirect Interest or interest being herein collectively called a "Transfer")

Transferability of Interests and Exit Strategies

B. Examples:

1. Buy-Sell vs. Forced Sale
2. Right of First Refusal vs. Right of First Offer
3. Drag Along vs. Tag Along

Transferability of Interests and Exit Strategies (cont'd)

Consider implications under loan agreements

- i. Require that as condition of exercise of buy-sell that the guarantor be released (or as fall back, have guarantor indemnified by credit worthy affiliate of purchaser)
- ii. Loan agreement may need to contemplate possible execution of buy-sell

Thank you

- If we can be of any further assistance with these issues, please contact us at:

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