

**INVESTOR AND DEVELOPER ISSUES
IN REAL ESTATE JOINT VENTURES**

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INVESTOR AND DEVELOPER ISSUES IN REAL ESTATE JOINT VENTURES

1. CAPITAL CONTRIBUTIONS

Investor:

- Clear expectation of what contributions will be required and which party is covering cost overruns
- Control over additional capital contributions
- Remedies for failure to contribute capital (loan, dilution)

Developer:

- Project needs continued funding, especially if the Developer has given completion or other guaranties to the lender
- Require parent guaranties for capital contributions if the members of the Joint Venture are special purpose entities (SPEs)
- No forfeiture of interest for failure to make capital contributions

2. RECOURSE GUARANTIES FOR VENTURE FINANCING

Investor:

- Clear expectation of which party will provide guaranties for venture financing
- Scope of guaranties
- Fees for providing guaranties
- Indemnity and capital contribution requirements

Developer:

- Indemnification from Joint Venture for liabilities under loan guaranties
- Requirement that Developer be released from its loan guaranties as a condition to removal as Manager
- Indemnification from Joint Venture if Developer is still liable under loan guaranties following removal

3. DISTRIBUTIONS

Investor:

- Priority of return of capital
- Shifting interest as hurdles achieved

- Offset rights against obligations owed to Joint Venture from Developer Parties
- Loss of economics for developer default

Developer:

- Determination of funds available for distribution
- Distributions within any tranche should be pro rata between Investor and Developer
- Tax distributions to address any phantom income issues for Developer

4. CONTROL

Investor:

- Day to day management of Joint Venture: Developer as Manager, Investor as Manager, Board
- Major Decisions focused on protecting investment and ensuring Investor abiding by its fiduciary obligations to its investors
- Removal of Developer as managing member upon default

Developer:

- Day to day management should be solely in the hands of Developer
- Approval of Major Decisions should be given quickly
- Approval should not be required for Major Decisions involving nonmaterial sums or to the extent already reflected in approved budgets, development plans, business plans, etc.
- Developer should not be required to devote all of its time to the business of the Joint Venture

5. LIMITATIONS OF LIABILITY

Investor:

- Waiver of any fiduciary duties of Investor to Joint Venture
- Personal recourse to Developer (and/or its principals) for “bad boy” actions taken by Developer as managing member
- Other Developer guaranties (performance, payment of capital contributions). Important for client to know what else Developer is out there doing in the market

- Recourse against Investor limited to its interest in Joint Venture

Developer:

- Narrow definition of duties and standard of care of the Developer to the Joint Venture
- No or very limited guaranties of Developer to Investor
- Indemnification of Developer for matters arising from its role as Manager

6. DEFAULTS AND REMEDIES

Investor:

- Performance hurdles for development projects
- Removal of managing member
- Control of money (bank accounts)
- Control over affiliate contracts
- Retention/removal of economic interest

Developer:

- Developer is not guaranteeing the economic success of the Joint Venture
- Developer should not lose its non-promote economic interest if it is removed as the Manager
- Developer should not have additional obligations if Investor is a real estate investment trust (REIT)

7. TRANSFER RESTRICTIONS

Investor:

- Flexibility for upstream transfers to reflect investment structure
- Limitation on any transfer of Developer interest (including pledges)

Developer:

- Transfers to affiliates and transfers for estate planning purposes should be permitted
- Investor should remain liable for capital contribution obligations following a transfer to an affiliate

8. EXIT RIGHTS

Investor:

- Exit rights should match hold requirements and investment horizons for investment structure
- Exit rights in face of impending maturity
- Choosing best option: buy/sell, ROFO

Developer:

- Developers usually have much shorter hold period expectations
- Determining the value of the Joint Venture
- Maintaining control of the marketing process if the project is going to be sold

9. DISPUTE RESOLUTION

Investor:

- Quick third party resolution
- Resolution process should not impede on Investor's fiduciary obligations to protect its investment (decision to remove Investor as managing member)

Developer:

- Should have a final determination of fraud, malfeasance or similar occurrences before triggering the removal of the Developer as Manager
- Provisions need to mesh with the requirements of the loan documents

10. DEVELOPER AFFILIATE RELATIONSHIPS WITH JOINT VENTURE

Investor:

- Control affiliate relationships with Joint Venture
- Right to terminate relationships upon default under JV Agreement
- Clear expectation of what it's going to cost
- Priority of payment of fees relative to other costs of the Joint Venture

Developer:

- No termination of agreements between Developer and the Joint Venture without cause

- Avoid guaranty-type obligations when Developer is serving in an oversight role (e.g., as construction manager under a construction management agreement)
- The only subordination of Developer fees under ancillary agreements should be to the lender

11. MISCELLANEOUS ISSUES

- Non-competition
- Tax Issues
- Single vs. Portfolio Investments