REAL ESTATE COUNSELORS

Business Focus: Key Issues in Joint Ventures

Bruce Rosen
BRosen@RECDC.com
(202) 577-3552

Peter Pokorny
Peter@RECDC.com
(703) 850-9099

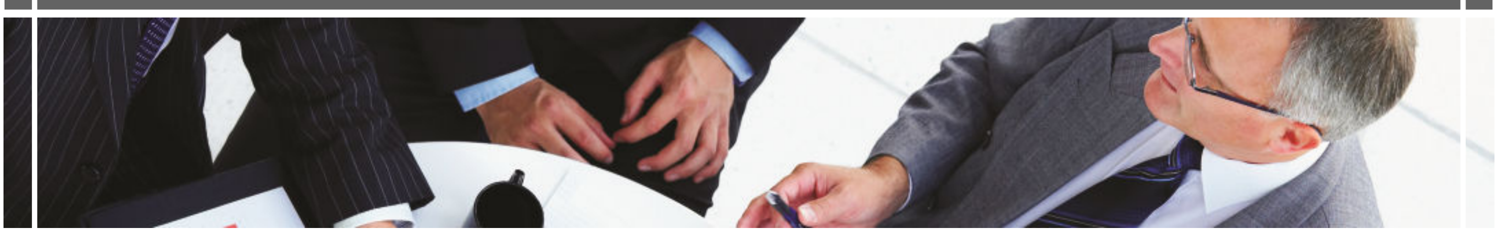
Introduction. A joint venture (JV) typically consists of an association of two or more people and/or entities with a view to sharing the profit or loss of a business venture in accordance with the JV agreement. Joint ventures are a common vehicle for providing equity funding for real estate projects. In many cases, one person (directly or through an entity) is the manager, making day-to-day decisions, while the other members are passive investors.

In years past, most joint ventures were limited partnerships with the general partner acting as manager, and the investors as limited partners. Today, the common structure is a limited liability company (LLC), where the investors are member. Usually, the manager is a member as well, though some LLCs have non-member managers.

A few key issues members in a JV face are discussed below.

Major Decisions. The members in a JV should consider key actions and determine what actions the manager can do on its own authority, what actions should require a majority approval of the members, and what actions (if any) should require unanimous consent of all members. Major decisions can include incurring debt, acquiring properties, investing in other businesses; requiring additional capital contributions; approving an annual business plan; and dissolving, liquidating or terminating the JV.

Capital Calls. A capital call is JV's request for additional equity contributions from its members. Issues can arise when one of the JV members cannot or will not meet its funding obligations. A well drafted JV agreement expressly addresses the rights and remedies available to members when one member fails to contribute its proportionate share of additional requested capital.



REAL ESTATE COUNSELORS

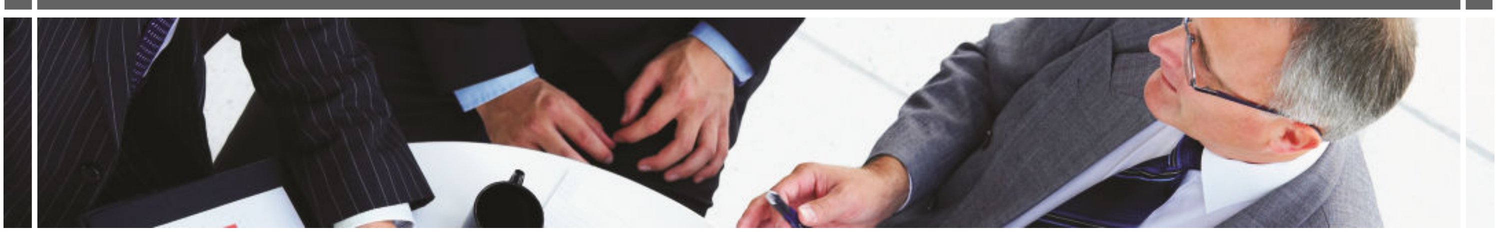
Business Focus: Key Issues in Joint Ventures

New Members. Sometimes to provide additional capital or other resources, the JV manager may want to admit a new member. Two issues that arise are (i) whether some or all members must approve the new members, and (ii) how admitting the new members may affect the shares of the other members. Absent complex "anti-dilution" strategies, the existing members would face a dilution of their membership interests. A well-documented example of this was the dilution of Eduardo Saverin, one of the original founders of Facebook.

Membership Transfers. Careful thought should be given to what circumstances members are permitted to transfer their interests to a third party. Often members will contractually restrict the right of developers or key principals to withdraw or resign from the JV to prevent them from assigning interests to a less capable performer. If the JV agreement is not carefully drafted, an easy way to circumvent transfer restrictions is through indirect transfers.

Exit Strategies. Exit strategies are procedures for ending the member's involvement in the JV. Many agreements provide one or more strategies in case the Members don't agree on when to sell. Strategies can include:

> **Buy-Sell Option.** This option provides a mechanism under which the Members may separate. One member acquires complete ownership of the venture and the other member liquidates its investment.
>
> **Put or Call.** When members know at the outset that one wants to hold the assets long term and the other wants to liquidate earlier, the agreement can provide for the sale of the latter member's interest to the former member under certain circumstances. A member can have the option to "put" its interest to the JV and compel a sale or to "call" the other member's interest and buy it.
>
> **Drag Along-Tag Along Rights.** These are rights where a member selling their interest can force other members to sell as well (drag along), or the other members can force the selling member to have the purchaser buy them out (tag along).



WWW.RECDC.COM
DC ◆ MD ◆ VA ◆ NY

DC: (202) 577-3352
MD: (240) 252-3386

NY: (646) 820-3013
VA: (703) 740-1766