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CRE INVESTORS:

SEEKING SECURITY

THROUGH JOINT VENTURES

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Commercial real estate developers, operators and investment sponsors

are continually faced with the challenge of sourcing capital in an increasingly competitive market, often relying on a blend of multiple sources to expand to the next stage of the business cycle.

CRE INVESTORS: SEEKING SECURITY THROUGH JOINT VENTURES

The good news for operators is that there is as much capital on the sidelines looking for quality real estate investment opportunities as ever before. However, while the money may be available, the nation's top investors are cautious about where to invest capital. Many are concerned that the CRE market is at or near the peak of its current investment cycle, and are therefore seeking strong cash flowing assets over value-add or opportunistic investments.

PREFERENCE FOR JVs

Traditionally, the most common options for raising capital have required sourcing equity through a commingled discretionary fund or through a joint venture relationship. In recent years, use of JVs has increased significantly, both in the United States and globally. Institutional investors tend to prefer investing through JVs and separate accounts over commingled funds, primarily out of a desire to maximize control over their investment.

The JV structure allows investors to know the exact asset or project their cash is funding. Access to detailed information and active involvement provides investor security, unlike discretionary funds where the sponsor unilaterally makes the investment decisions.

LEVEL OF CONTROL

Typically, JV investors are also given a voice in major decisions as well as control over how their capital contributions are allocated within a project. It's important both parties agree in advance on what decisions will require investor consent and which they'll entrust the developer to manage. In such partnerships, completion and cost overrun risks are routinely placed on the developer or operator. Contracts often grant JV partners the power to remove the developer or operator in certain circumstances, and joint venture agreements typically contain buy-sell provisions, which may allow a greater potential for liquidity.

Due to the level of control required by most JV investors, real estate developers and operators often, unsurprisingly, prefer the commingled discretionary fund structure. Discretionary funding enables the operators to act quickly when making an investment decision, which is often essential in this fast-moving real estate market.

It is not always practical to negotiate a JV agreement when pursuing a competitive opportunity. That said, operators may need their own equity to close a deal, or they may have bridge financing in place that will be taken out by a JV partner. A discretionary fund enables a developer to avoid those constraints.

FIRST-TIME FUND SPONSOR

Having a single investor creates more efficiency and simplifies reporting, as JV partners may have specific reporting requirements. Plus, obtaining follow-on investments can be easier.

However, in the current environment, a first-time fund sponsor will likely need all of the following to have success in raising sufficient capital for their commercial real estate project: a unique

opportunity, an especially strong track record, a team with a breadth of experience and significant skin in the game and quality seed assets.

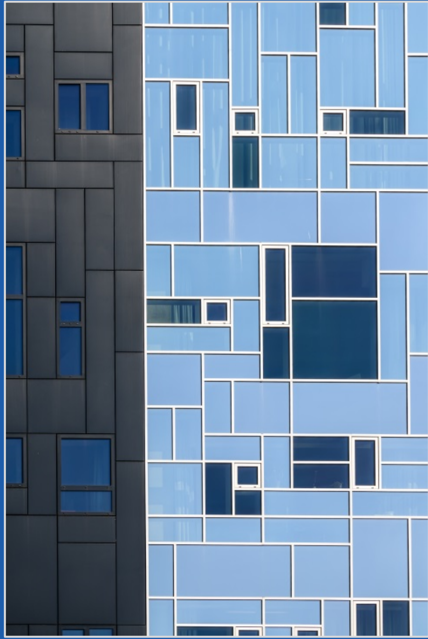
It is important for developers to recognize that JV partnerships can also provide favorable opportunities for developers and operators that are not available in the more traditional fund structure. The fee structure and distribution waterfall— return percentages based on each investors' capital investment—often have more flexibility in a JV arrangement.

Sophisticated JV investors routinely bring helpful ways to drive value in a project while providing greater access to other beneficial relationships with lenders, suppliers, contractors, tenants and other end users.

KEYS FOR NEGOTIATING A REAL ESTATE JV

It's important to clearly address, define and agree upon the following 12 key issues when negotiating a real estate JV agreement:

1. Obligation to make capital contributions and the timing of the contributions
2. Significant consequences for failure to make a required capital contribution
3. Ability of developer/operator to fund a portion of its capital contribution through deferral of fees
4. Requirement of parties to fund cost overruns and operating shortfalls
5. Discretion of developer/operator to reallocate among line items in the development or operating budget
6. Management authority of the developer/operator and major decision items requiring approval of the investor
7. Circumstances where the developer/operator can be removed as manager of the joint venture
8. Timing of when transfers of membership interests in the joint venture can take place
9. Buy/Sell provisions clearly stating when a party can force the sale of the real estate owned by the joint venture
10. How to deal with deadlock situations between the investor and the developer/operator
11. Limits on competitive projects by either party
12. The distribution waterfall and compensation of the developer/operator



JV investors are often seeking programmatic investment opportunities

and may ultimately offer equity for multiple projects, which makes these partnerships potentially more prosperous for all parties. Once the first deal has been negotiated, future transactions with the investor can happen much more quickly.

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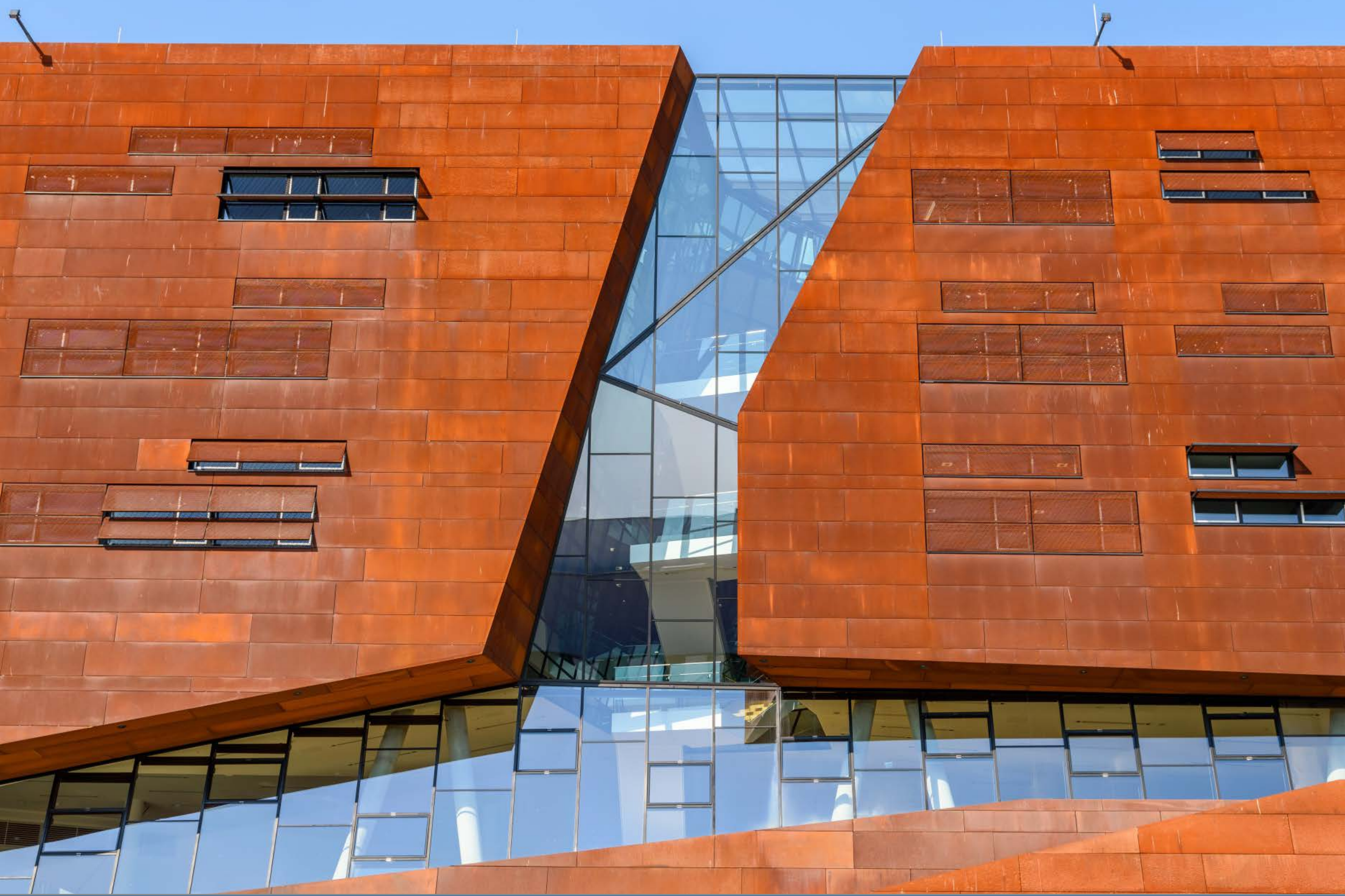

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