The Business of Joint Ventures

Monte Franke

For NY DHCR/HTFC

Funded by HTFC & HUD-NY CDTA

Objectives

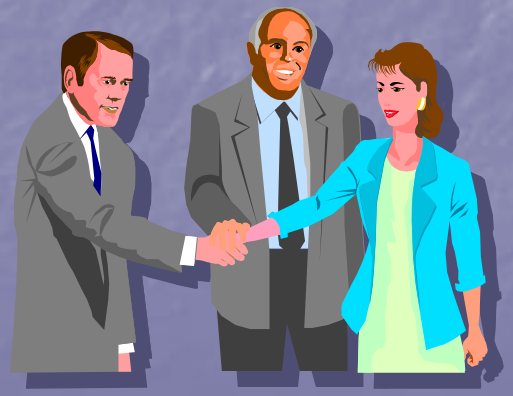
To help nonprofits:

1. Make informed decisions about when to consider a joint venture
2. Understand the structure of joint ventures
3. Develop skills to select good partners & negotiate successful joint ventures

Agenda

- Making the decision to joint venture
- The structure of a joint venture
- Selecting partners & negotiating a joint venture

Making the Decision to Joint Venture



Why Partner?

- Raise equity
- "Acquire" skills
- Leverage your capacity – opportunity cost

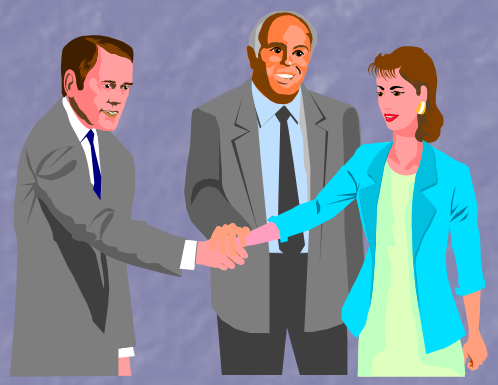
When Should You Partner?

- When project requires it
  - Tax credits: equity (limited) partners
- When project exceeds nonprofit capacity
  - Specific skills/expertise
  - Equity
  - Access to construction & other loans
- When nonprofit needs to leverage capacity
  - Lack of staff to take on additional project
  - New kind of housing project

Why Not Consultants?

- If all you need is certain development skills, a consultant might be appropriate
- But a partner may be more appropriate if you need:
  - Resources: partners can bring resources & access to resources
  - Risk sharing: partners share risks (& success)
  - Post-development participation: partners can bring service provision & management skills

Partnering: A Balancing Act



- The 3 Big Issues
  - Control
  - Risk/liability
  - Rewards
- Need to achieve (& maintain) a balance of the three

Control Issues

- Control & participation in development decisions:
  - Scope of project
  - Budget and financing
  - Implementation
  - Marketing & occupancy management
  - Disposition
- Control usually reflects ownership interest; ownership interest reflects equity

Liability Issues

- Liability needs to be balanced with control & compensation
  - Whoever takes on risk must be compensated
- Liability includes:
  - Equity at risk
  - Loan guarantees & recourse debt
  - Performance guarantees
  - Collateral
  - Other contingent liabilities

Rewards of Development

	Affordable Housing
Fees	√
Cash flow	
Tax benefits	LIHC only
Sales proceeds/residuals	

Developer Fees

- Fees are for services rendered; Profit is return on equity invested
- Fees versus costs
- Consultant costs paid out of fees
- Partnership issues:
  - Fee split: based on div. of responsibilities
  - Deferral of fees; escrow for buyout

Discussion

- What potential projects in your community might require partnering? Why?
- Now, as a small group, do Joint Venture Activity 1.

The Structure of a Joint Venture

Types of Partnerships

- Joint venture: development partnership
  - The focus of this seminar
- Joint venture: turnkey
  - Emphasis is on the conditions of the "handoff"
- Limited partnerships: Tax Credits

Key Parameters

1. Scope of project
2. Ownership interest
3. Decision-making
4. Equity calls
5. Division of responsibilities
6. Split of developer fees
7. Guarantees
8. Dispute resolution
9. Termination
10. Buyout clauses – if applicable

1. Scope of Venture

- Principal scope issues:
  - Type/number of units
  - Targeted households
  - Term of project
  - Low income use provisions/restrictions
- Essential v. desirable
  - What can be compromised & how

2. Ownership Interest

- Ownership entity
  - Partnership, LLC, LP, etc.
- Initial ownership interests
  - Ownership interest reflects equity (alt. equity) contributed
- Change in ownership interest due to equity calls
- Sale of ownership interest
  - Right of 1st refusal by other partners
- Succession in event of death/demise of partner

3. Decision-making

- Voting rights based on ownership interest
- Decisions that must be made jointly:
  - Incur debt or financial obligations, incl contracts
  - Changes in project scope
- Decisions individual partners can make in fulfilling developer obligations

4. Equity

- Equity calls
- Return <u>on</u> equity
  - Terms for distributions of income
- Return <u>of</u> equity
  - When/how capital advances are repaid

Activity

- In your small group, discuss Joint Venture Activity 2

5. Division of Responsibilities

- Division of project management responsibilities:
  - Joint venture management: fin mgt/accounting, equity calls & disbursements, reporting (IRS/partners)
  - Acquisition
  - Financing: responsibility by funding source
  - Design: oversight of architects
  - Local approvals
  - Construction: oversight of contractor
  - Marketing & occupancy
  - Property management: oversight of property manager
- Right to complete (& process) if partner fails to fulfill responsibility

6. Split of Developer Fees

- Principle:
  - Fees are earned for services rendered
- Steps:
  - Identify total fees
  - Identify all developer tasks
  - Assign %/$ value to each task
  - Divide up fees based on who does tasks (item 5)

Activity

- In your group, do Joint Venture Activity 3

7. Guarantees

- Loan guarantees & recourse debt
- Performance guarantees
- Other guarantees & contingent liabilities

8. Dispute Resolution

- If agreement cannot be made under decision-making guidelines
  - Especially important if 50-50
- Options:
  - Mediation
  - Arbitration
  - Litigation

9. Termination

- Premature termination of project
- Completion/closeout of project
  - Final accounting & disposition of assets

10. Buyout/Handoff

- Buyout
  - LIHC partnerships & other nonprofit/forprofit ventures
  - Nonprofit should negotiate for:
    - Right of first refusal
    - Buyout formula
    - Maximized residual interest
      - Trade current interests for residual interests
    - Financing structure to minimize residual value:
      - Grants/subsidies converted to nonprofit loans to projects
      - Ground leases/land trusts
    - Dedicated/escrowed fees & distributions
      - Escrow portions of developer fees
      - Management incentive payments & distributions

Handoff

- If for-profit partners want out after fees/tax benefits earned
- If service nonprofit is taking over ownership/mgt
- Need:
  - Standards for completion and acceptance
  - Process for handoff

Negotiating a Joint Venture

Selecting A Partner

- What do you look for in a partner?
  - Developer skills – mgt skills
  - Technical skills
  - Experience working with partners, especially nonprofits
  - Trustworthy
- How do you find a partner?

Negotiating Tip 1

1. Seeking the win-win, or the 3rd alternative
   - What's important to me? To "them"?
   - Can we achieve both?

How Are We Different?

- Things nonprofits tend to emphasize:
  - Affordability
  - Community input
  - Occupancy
  - Long-term control
- Things for-profits tend to emphasize:
  - Timely completion
  - Payoff of construction loans & other recourse debt
  - Earning full developer fee
  - Minimize long-term responsibility/liability

How Are We Alike?

- Our long-term success and survival is determined by quality projects completed in a timely manner on budget

Negotiating Tip 2

- Balance risk-reward for all partners
- Risk management
  - What's my exposure?
  - How can I reduce risk?

What Nonprofits Bring

- Site control
- Neighborhood support
- Local government support
- Government & foundation funding
- Experience with local process

Negotiating Tip 3

- Put it in writing
  - Trust, but document it!
- Document the business deal before turning it over to the lawyers
- Don't sign till you understand!

Joint Venture Agreements

- MOU: the business deal
  - Tip: follow the 10 Elements
- Joint Venture Agreement: the legal deal
- Syndication agreement: for Tax Credits

Legal Protections in Agreement

- Joint approval in writing of major decisions
- Regular meetings
- Right to examine books/records
- Receipt of monthly/annual reports
- Disclosure requirements
- Dual signatures on checks & documents
- Bonding
- Prohibition against self-dealing
- Arbitration/mediation

Activity

- In your group, develop negotiation strategy using Joint Venture Activity 4

Things to Remember

1. If you need specific task/skill, hire a consultant; if you need resources, risk sharing &/or mgt, get a partner
2. Balance control, liability & rewards
3. Control = ownership interest = equity
4. Split dev fee by tasks, then among partners
5. Plan for the end(s) of the venture
6. Seek compatible partner you can trust
7. Negotiate with full disclosure (non-negotiables); seek win-win
8. Document business deal; then legal deal

Wrap Up

- Please complete the Evaluation
- Future Seminars:
  - June: Homebuyer Projects
  - July: Property Management
  - August: Designing Energy Efficient Housing Projects
  - September: Acquisition, Rehab, Resale for CHDOs

Safe travels. See you next month!