Joint Ventures for CHDOs & Nonprofits

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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
- Structure of a joint venture: 10 points
- Selecting partners & negotiating a joint venture: 5 negotiating tips

Making the Decision to Joint Venture

Discussion

- Have you partnered before?
- What type of project? Why did you partner?
- What was your experience? What are the lessons learned?

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 your capacity
  - Specific skills/expertise; new kind of project
  - Equity
  - Access to lenders & borrowing capacity
- When you need to leverage capacity
  - Lack of staff to take on additional project; opportunity cost

Consultant v. Partner?

Consultant if you need:

- Development skills
- Temporary capacity to perform developer tasks

Partner if you need:

- Equity
- Access to resources
- Risk sharing
- Post-development participation

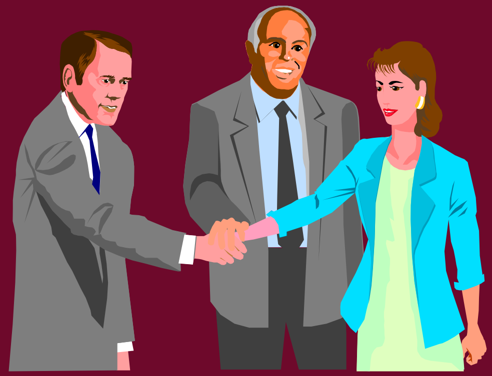
Discussion

- What types of projects might cause you to consider a partner? Why?

Types of Partnerships

- Joint venture: development partnership
- Joint venture: turnkey
  - Emphasis is on the conditions of the “handoff”
- Limited partnerships: Tax Credits

Essence of the Joint Venture



- Balancing the 4 R's:
  - *Rule (control)*
  - *Risk*
  - *Responsibilities*
  - *Rewards*

Rule: Control Issues

- Who makes key development decisions?
  - Scope of project
  - Budget and financing
  - Implementation
  - Marketing & occupancy management
  - Disposition
- Equity = ownership interest = control

Risk & Liability Issues

- Liability includes:
  - *Equity at risk (& timing of equity)*
  - *Loan guarantees & recourse debt*
  - *Performance guarantees*
  - *Collateral & other contingent liabilities*
- Balance liability, control & compensation
  - *Whoever takes on risk must be compensated*

Responsibilities

- Developer responsibilities:
  - *Define project scope*
  - *Hire/manage the team*
  - *Obtain approvals; manage comm relations*
  - *Oversee design & construction*
  - *Obtain financing; control the budget; draw/disburse funds*
  - *Oversee marketing & management/sale*

Rewards of Development

	Affordable Housing
Fees	√
Cash flow	
Tax benefits	LIHC
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*

What to Look for in a Partner

- Developer skills – project mgt skills
- Technical skills – knowledge of specific project type & funding source
- Unique access to property/resources
- Experience working with partners, esp nonprofits
- Trustworthy

Finding a Partner

- How do you find a partner?
  - Referral & reputation search
  - Ask funders, lenders, public agencies
- Checking references
  - Ask: would you partner with them again?

Activity

- Read Joint Venture Activity 1 & answer questions for discussion

The Structure of a Joint Venture

Elements of the Business Deal

Elements of the Business Deal

1. Scope of project
2. Ownership interest
3. Decision-making
4. Equity/capital advances
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:
  - Number/mix of units (& other uses)
  - Targeted households
  - Term of project
  - Low income affordability/use restrictions
- Changes to scope:
  - Non-negotiable v. desirable
  - What changes of scope can be made & how changes will be decided?

2. Ownership Interest

- Ownership entity
  - Partnership, LLC, LP, etc.
- Initial ownership interests
  - Ownership interest reflects equity contributed
- Change/sale of ownership interest
  - How partners acquire
  - 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/Capital Advances

- Equity calls
  - Timing, default, redemption
- Return <u>of</u> equity
  - When/how capital advances are repaid
- Return <u>on</u> equity
  - Terms for distribution of income

Activity

- Do Joint Venture Activity 2

5. Division of Responsibilities

- Division of project mgt 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 if partner fails to fulfill

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

- 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

- Tax credit LPs & nonprofit/forprofit ventures
- Nonprofit should negotiate for:
  - *Right of first refusal*
  - *Favorable formula for buyout "price"*
  - *Management fees & distributions*
  - *Maximized residual interest of nonprofit*
  - *Public financing structured to minimize residual value to partners but assumable by nonprofit*

Financial Tools of Buyouts

- Grants/subsidies converted to nonprofit loans to projects (& accruing interest)
- Ground leases/land trusts to control land value
- Escrow portion of developer fees dedicated to buyout (sinking fund)
- Management incentive payments & distributions

Handoff

- Handoff situations:
  - For-profit partner wants out after dev
  - Service nonprofit takes over ownership/mgt
- Need to specify:
  - Standards for completion and acceptance
  - Warranty (fee retention or guarantee)
  - Process for handoff (incl lender approvals)

Negotiating a Joint Venture

Negotiating Tip 1

Prepare by analyzing the differences and the shared interests

- *How are we different?*
- *What can we each bring to table?*
- *What are our shared interests?*

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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 constr loans & other recourse debt*
  - *Earning full dev fee*
  - *Minimize long-term responsibility/liability*

What Nonprofits May Bring

- Site control
- Neighborhood support
- Local government support
- Government & foundation funding
- Experience with local process
- Access to/experience with customer base
- Willingness to manage long-term

What For-Profits May Bring

- Equity & capital advance liquidity
- Bank relationships & access to construction loans
- Personal guarantees
- Experience
- Construction management

How Are We Alike?

- Our long-term success and survival is determined by quality projects completed in a timely manner on budget
- We can’t survive if we don’t earn fees

Negotiating Tip 2

Identify/disclose the “non-negotiables”

- *What are deal-killers for you? E.g.:*
  - Income levels served
  - Control of occupancy
  - Community participation
  - Financial issues (risks, rewards)
- *What are deal-killers for your partner?*

Negotiating Tip 3

Seek the win-win, or the 3rd alternative

- *You can't have a successful partnership with an unhappy partner*
- *But you can't be unrealistic in your expectations either*
- *Both sides have to give to get*
- *Can we achieve a partnership deal that achieves both of our needs?*

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Negotiating Tip 4

Balance risk-reward for all partners

- *Balance*
  - Control v. risk/liability
  - Responsibilities v. fees & other rewards
- *Consider risk management*
  - What's my exposure?
  - How can I reduce risk?

Negotiating Tip 5

- Put the business deal 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

- Joint Venture MOU: the business deal
  - *Tip: follow the 10 Elements*
  - *Do this first, before the lawyers take over*
- Joint Venture Agreement: the legal deal
- Syndication agreement: for Tax Credits

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And Now the Lawyers…

- *Joint approval in writing of major decisions*
- *Regular partner 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 a skill, hire a consultant; if you need resources, risk sharing or mgt, partner
2. Seek a compatible partner you can trust
3. Equity = ownership interest = control
4. Developer fees: split per responsibilities
5. Seek balanced win-win
6. Plan for the end(s) of the venture
7. Document business deal 1st; then legal deal

Wrap Up

- Please complete the Evaluation
- Next Seminar:
  - *December: Working with Homebuyers*
- Ideas for next year?

Safe travels. See you next month!