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## **Structuring Real Estate Joint Ventures to Address Loan and Manager Defaults, Bankruptcy, Distressed Property**

Management Removal Provisions; Effect on Promote, Distributions, Exit Rights, Third-Party Contracts

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THURSDAY, AUGUST 30, 2018

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

Stuart Brown, Partner, **DLA Piper**, Wilmington, Del.

Thomas G. Maira, Partner, **DLA Piper**, New York

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# Structuring Real Estate Joint Ventures to Address Loan and Manager Defaults, Bankruptcy and Distressed Property

Strafford Webinar  
August 30, 2018



## Presenters

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# Structuring Real Estate Joint Ventures to Address Loan and Manager Defaults, Bankruptcy and Distressed Property

- I. Introduction
- II. Property Distress Anticipation
- III. Loan Defaults
- IV. Operator / Developer Defaults
- V. Capital Partner Defaults
- VI. Bankruptcy Aspects of Real Estate Joint Ventures



## I. INTRODUCTION

- A. It's all good until it's bad (Relationship, Trust, "good deal")
- B. Where are we in the cycle is always a question
- C. Other than economic deal, a main point of JV document (obviously) is what happens when the Property is in distress or a party defaults
- D. Anticipating what can go wrong and what happens if it does is the general theme of this presentation
- E. In particular, often Private Equity Real Estate JV deals by their nature may have more risk and complication so that higher target returns to Capital Partner are warranted since traditional lenders may not be willing to take the risk





## II. PROPERTY DISTRESS ANTICIPATION

### A. Required Additional Capital Contributions

#### 1. Operating Cost Overruns

- a. Approved Budget
- b. Less common for this to be a risk allocated solely to Operator

#### 2. Development Cost Overruns

- a. Approved Budget
- b. More common for Developer to be at risk for cost above Approved Budget



## II. PROPERTY DISTRESS ANTICIPATION

### B. Failure to Make Required Capital Contributions (Remedies and Disincentives)

#### 1. Options of Capital Partner

- a. Termination of Future Capital Contribution Obligations
- b. Capital Contribution with Default Preferred Return
- c. Member Loan at Default Interest Rate
- d. Preferred Distribution Rights to Repay
- e. Dilution of Defaulting Partner Economic Percentages
  - (i) Pro Rata
  - (ii) Disproportionate
- f. Loss of Economics (Fees, Return of Capital (for bad act?) )and/or Promote)
- g. Waterfall Adjustments



## II. PROPERTY DISTRESS ANTICIPATION

### C. Credit Support for Transaction

1. Loan Guaranty Requirements (Credit or Personal) given by Developer/Operator and/or Capital Partner to Lender (Guaranty Fee)
2. Guarantee of Sponsor Obligations under JV Agreement in favor of Capital Partner (Credit, Personal and/or Developer/Operator economics)
3. Guaranteed Maximum Price Contract from General Contractor (Credit, Bonded or Bondable)
4. Golden Share provisions restricting ability to take certain action without express consent



## II. PROPERTY DISTRESS ANTICIPATION

### D. Cross Defaults

1. Programatic JV with Subsidiary Project Entities
  - a. Return of capital on all projects prior to Promote distributions
2. Crossed Deals Without Programatic JV
  - a. Some or all of Promote is directed to other crossed deals until capital is returned on all deals
  - b. Promote paid so long as other deals on budget
  - c. Clawbacks
3. Bankruptcy Issues regarding Rendered Insolvent and Cross Default



## II. PROPERTY DISTRESS ANTICIPATION

### E. Bankruptcy Clauses in Real Estate JV's

1. What should be in the document?
2. How effective/enforceable?



### III. LOAN DEFAULT AND ISSUES

- A. Developer/Operator Cause vs. Without Cause
- B. Change/Takeover of Day to Day Management
- C. Change/Takeover of Major Decision Rights  
(e.g., Capital Partner can Amend/Restructure Loan; Sell Property, Refinance, etc.)
- D. Removal of Developer/Operator
- E. Issue of Developer/Operator remaining on Guaranty  
(Payment, Performance, Non-Recourse Carve-Out) and  
Environmental Indemnity (Requirement to remove?  
Indemnity?)
- F. Bankruptcy not an option at Asset Owner entity level  
(if Non-Recourse Carve-Out Guaranty) vs. Golden Share/Involuntary Bankruptcy
- G. Right to replace Developer/Operator or Capital Partner with  
qualified parties (for operation and under Loan Documents and under any Loan  
Guarantees)
- H. Right without lender consent to transfer direct and indirect  
interests pursuant to JV Buy-Sell, ROFO, etc.

## IV. OPERATOR / DEVELOPER DEFAULT

- A. Failure of Standards
- B. Bad Acts
- C. Failure to Contribute Required Capital
- D. Failure to pay Cost Overruns
- E. Failure to meet performance obligations, if any
- F. Reporting Failures (per diem penalties)
- G. Taking Unauthorized Actions/Major Decisions
- H. Unauthorized Transfers/Change of Control
- I. Developer/Operator Bankruptcy
  1. What should be in the JV Agreement?
  2. Non-Recourse Carve-Out Guaranty if Voluntary Bankruptcy
- J. Remedies
  1. Change/Takeover of Day to Day Management
  2. Change/Takeover of Major Decision Rights  
(e.g., Capital Partner can Amend/Restructure Loan; Sell Property, Refinance, etc.)
  3. Removal of Developer/Operator

## V. CAPITAL PARTNER DEFAULT

- A. Failure to Contribute Required Capital
- B. Implementing Major Decisions that require Developer/Operator Approval
- C. What Remedies does Developer/Operator have
  - a. Often if Developer/Operator is only a 5%-10% Capital contributor, the remedy is only damages for a breach
  - b. If Developer/Operator has large share of Capital Contribution (e.g. 50%/50%) then Developer/Operator would have more remedies like Capital Partner (see IV above)
- D. Capital Partner Bankruptcy issues

Executory nature of Contracts

Personal Services

Set off





## VI. BANKRUPTCY ISSUES IN REAL ESTATE JOINT VENTURES

- A. Single asset real estate case
- B. Replace manager followed by Voluntary Bankruptcy
- C. Involuntary Bankruptcy
- D. Sale v. Restructuring
- E. Loan to Own Strategies
- F. Control of Process through Financing
- G. Distinguish between Receivership and Bankruptcy