

# Structuring Real Estate JVs: Capital Contributions, Distributions, Allocations, Taxes, Governance, Exit Strategies

Negotiating Joint Venture Deals in Property Development to Minimize Financial and Legal Risks

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

Today's faculty features:

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# **Structuring Real Estate JVs: Capital Contributions, Distributions, Allocations, Taxes, Governance, Exit Strategies**

Strafford Webinars  
July 27, 2017

# Session Team

- Lloyd G. Kepple, Moderator  
Fox Rothschild LLP
- Jonathan McLester  
GreerWalker LLP
- Thomas Maira  
DLA Piper LLP (US)

# Structuring Real Estate JVs

- I. Capital Contributions and Capital Calls  
(Who Puts the Money In and When?)
- II. Distributions (Who Gets the Money Out  
and When?)
- III. Governance and Control Issues  
(Who's in Charge Here: What % of the Capital?)
- IV. Exit Strategies  
(Which Way is Out?)
- V. Tax Aspects of Joint Ventures

# I. Capital Contributions and Capital Calls (Who Puts the Money In and When?)

Lloyd G. Kepple, Fox Rothschild LLP

- A. Initial Capital Contributions (ICCs)
  - 1. Percentages from Money Partner/Sponsor Partner
  - 2. Timing of Contributions
  - 3. Preferred Return on Contributions
  
- B. Additional Capital Contribution (ACCs)
  - 1. Required ACCs
  - 2. Development Cost Overrun
  - 3. Operating Cost Overruns
  
- C. Due Diligence Conditions to Capital Contributions



# I. Capital Contributions and Capital Calls (Who Puts the Money In and When?)

Lloyd G. Kepple, Fox Rothschild LLP

## D. Failure to Make Capital Contributions (and Consequences)

### 1. Options of Contribution Partner

- a. Withdrawal of Contribution
- b. Default Capital Contribution (DCC)  
with Default Preferred Return
- c. Default Loan at Default Interest Rate
- d. Preferred Distribution Rights to Repay Loan and DCCs
- e. Squeeze down of Defaulting Partner Percentages
  - (i) Pro Rata
  - (ii) Disproportionate
- f. Removal/Buy-Sell Exercise

# I. Capital Contributions and Capital Calls (Who Puts the Money In and When?)

Lloyd G. Kepple, Fox Rothschild LLP

- E. Credit Support for Transaction
  - 1. Financing Guarantee Requirements
  - 2. Guarantee of Sponsor Obligations under JV Agreement
  - 3. Bonding Obligations
- F. Capital Contributions – Tax Issues (McLester)
  - 1. Debt vs. Equity
  - 2. Tax capital/basis increases
  - 3. Property with FMV ≠ tax basis
    - Agreed upon FMV
    - Method of Sec. 704(c) allocations
  - 4. Sec. 704(b) “book-up” events



# II. Distributions (Who Gets the Money Out and When?)

Lloyd G. Kepple, Fox Rothschild LLP

## A. Distribution Waterfall Components

1. Preferred Return
2. Return of Capital
3. *Pari Passu*/Preferred Priority Tranches
4. Promote to Sponsor following Return of Capital
5. IRR/Contribution Multiple Hurdles

# II. Distributions (Who Gets the Money Out and When?)

Lloyd G. Kepple, Fox Rothschild LLP

## B. Waterfall Structure

1. Multiple or Unified Waterfalls Within a Project
  - a. Sales/Refinancing Proceeds
  - b. Operating Cash Flow Proceeds
  
2. Typical Waterfall Examples of Capital
  - a. Default Capital and Preferred Return
  - b. Initial Capital and Preferred Return
  - c. Additional Capital and Preferred Return
  - d. Interim Percentage until Money Partner achieves Hurdle Rate (Promote Distribution to Sponsor)
  - e. Cost Overrun Capital Return
  - f. Residual Percentage Distribution (Promote Distribution to Sponsor)

# II. Distributions (Who Gets the Money Out and When?)

Lloyd G. Kepple, Fox Rothschild LLP

## B. Waterfall Structure (cont.)

### 3. Waterfalls in Multiple Projects Scenarios

#### a. Master LLC with Sub-Tier Project Entities

- (1) Assures return of capital on all projects prior to Promote distributions

#### b. Crossed Deals Without Master LLC

- (1) Some or all of Promote is directed to other crossed deals until capital is returned on all deals
- (2) Promote paid so long as other deals on budget
- (3) Concept of creating a Reserve for Promote pending achievement of capital return requirements

# II. Distributions (Who Gets the Money Out and When?)

Lloyd G. Kepple, Fox Rothschild LLP

## C. Developer Fees

1. Amount:
  - (i) percentage of net sales proceeds
  - (ii) monthly based on percentage of construction budget
2. Timing:
  - Tied to Lease-up, Breakeven or other hurdle events?
3. Property Management Fees during operational phase

## D. Distributions – Tax Issues (McLester)

1. Tax capital/basis decreases
2. Distributions > basis = taxable gain
3. Disguised sale transactions
4. Tax distributions
5. Tax withholding

# III. Governance and Control Issues (Who's in Charge Here: What % of the Capital?)

Thomas Maira, DLA Piper LLP (US)

- A. Operational Authority and Duties  
(Operating Partner)
  - 1. Day to Day Business and Affairs
  - 2. Cash Management / Bank Accounts
  - 3. Reporting Obligations
  - 4. Operating Obligations
    - a. Standards
    - b. Performance
    - c. Compliance with third party agreements



# III. Governance and Control Issues (Who's in Charge Here: What % of the Capital?)

Thomas Maira, DLA Piper LLP (US)

- B. Major Decision Approval, Blocking Rights or Negative Control (Capital Partner)
  - 1. Sale
  - 2. Financing
  - 3. Refinancing
  - 4. Business Plan
  - 5. Operating Budget
  - 6. Capital Budget

# III. Governance and Control Issues (Who's in Charge Here: What % of the Capital?)

Thomas Maira, DLA Piper LLP (US)

## B. Major Decision Approval, Blocking Rights or Negative Control (Capital Partner) (cont.)

### 7. Third Party Agreements

- a. New
- b. Amendment
- c. Termination
- d. Enforcement

### 8. Leasing

### 9. Litigation

### 10. Bankruptcy

# III. Governance and Control Issues (Who's in Charge Here: What % of the Capital?)

Thomas Maira, DLA Piper LLP (US)

- C. Mandated Actions of Affirmative Control (Capital Partner)
  - 1. For Cause (Default or Bad Act)
    - a. Sale
    - b. Financing
    - c. Refinancing
- D. Related Party Agreements  
(between operating partner and its affiliates- e.g., property management and construction management agreements)
  - 1. Calling of Default
  - 2. Enforcement of Remedies
    - i. Offset against fees
    - ii. Termination

# III. Governance and Control Issues (Who's in Charge Here: What % of the Capital?)

Thomas Maira, DLA Piper LLP (US)

## E. Governance and Control – Tax Issues (McLester)

1. Tax return compliance
  - a. Who hires the accountants
  - b. Who makes decisions on grey area issues
  - c. Who reviews/approves prior to filing
  - d. Partnership level elections
  - e. Timing of K-1s

# III. Governance and Control Issues (Who's in Charge Here: What % of the Capital?)

Thomas Maira, DLA Piper LLP (US)

## E. Governance and Control – Tax Issues (cont.)

### 2. IRS Audits

#### a. “Old Rules”

- i. TEFRA vs non-TEFRA
- ii. Tax Matters Partner
- iii. Adjustments pass through

#### b. “New Rules”

- i. Effective tax years beginning after 12/31/17
- ii. Partnership Representative
- iii. Adjustments pass through vs access partnership



# IV. Exit Strategies (Which Way is Out?)

Thomas Maira, DLA Piper LLP (US)

- A. Removal of Operating Partner For Cause
  - 1. Default
  - 2. Bad Act
- B. Buy - Sell (mutual opportunity)
  - 1. After Lock-Out Period
  - 2. Major Decision Deadlock
- C. Put - Call Options or Buy-Out Rights (unilateral right)
  - 1. After Lock-Out Period
  - 2. Major Decision Deadlock

# IV. Exit Strategies (Which Way is Out?)

Thomas Maira, DLA Piper LLP (US)

- D. Forced Sale (Default, Bad Act)
- E. Transfer of Interest
  1. Capital Partners broad transfer rights / Operating Partner Buy-Out Right
  2. Operating Partners transfer restrictions
- F. Exit Strategies – Tax Issues (McLester)
  1. Capital Gain vs Ordinary Income
  2. Depreciation Recapture
  3. Like-kind Exchanges
  4. Equity Rollover



# V. Tax Aspects of Joint Ventures

Jonathan McLester, GreerWalker LLP

## A. Other Tax Issues

### 1. Income Allocations

- a. Must line up with economics
- b. Layer cake vs targeted capital accounts
- c. “Phantom income”
- d. Regulatory allocations
  - i. Nonrecourse deductions
  - ii. Minimum gain

### 2. Profits interest (aka “carry” or “promote”)

- a. Services provided
- b. Zero capital account

# V. Tax Aspects of Joint Ventures

Jonathan McLester, GreerWalker LLP

- A. Other Tax Issues (cont.)
  - 3. Unrelated Business Taxable Income (UBTI)
  - 4. Tax withholding
    - a. ECI
    - b. FIRPTA
    - c. State withholding

# Thank You!

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