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How deals are being made today: Joint ventures are complicated, expensive solutions

jm John Maltz

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"Thank you for making me $20 million!" Well, you know as a broker you're doing something right when both your customer and prospect send you the same thank you card.

A complicated, expensive real estate world requires complicated solutions. One of the most complicated is a joint venture transaction. To receive your own thank you cards can be easy if a few of the principle's of a joint venture partnership are carefully observed.

By way of background, generally, a real estate joint venture brings together property ownership, money, and a qualified developer. Generally, the money is provided by a third party lender which creates the first imbalance that most joint venture discussions stumble over. So... rule #1: The party to the venture without the collateral provides personal guarantees on all debt.

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Equality among partners is more than how the profits are divided, but rather their relative strengths. Regardless of an attorney's drafting skill, a significant imbalance in either net worth or business experience will generally lead to irreconcible issues during the development phase of the project. Therefore, rule #2: Match your partners carefully.

Each partner to a joint venture always has alternative transactions possibilities. The property owner can make an outright sale, or lease, or refinance the property. The developer can spend its finite amount of time and personnel on other possibly more lucrative deals. The benefits to both participants must be significantly better than not joining together. And this leads to rule #3: Clearly present and support the projected value of the finished product.

A typical joint venture project always ends up with one of the partners having done the lion's share of the work. The resulting acrimony will sink the joint venture if unforeseen obstacles and/or market conditions create heavy going, which always occurs to a greater or lesser degree. Therefore, rule #4: Delineate responsibilities and create realistic expectations as to each party's participation in the venture.

The joint ventures that have the least likelihood of succeeding are those with the greatest number of conditions underlying the final product. The amount and terms of the construction loan, the possibility of acquiring a variance for higher density or a zoning change, the lack of knowledge regarding site conditions such as subsoil conditions and environmental remediation can all place significant additional time and cost burdens onto one or the other partner. Therefore, rule #5: Thoroughly know the attributes of the property.

Joint ventures do not always require partners to be in touch either on a daily, weekly, or monthly basis. Compatible partners can be from completely different backgrounds, educational levels, and age levels. The correct structuring of the venture will create the framework for a working relationship over time. Therefore, rule #6: Do not pre-judge the social compatibility of the partners when structuring a transaction.

Hotel development has been the most recent impetitus to joint venture creations in the New York City area. While location, site size, and acquisition cost are the fundamental ingredients to half of the equation, the other half requires a developer with solid contacts and a track record with the major "flags." These ventures are generally well-balanced, for even if the developer is in a different weight class than the property's ownership, the leverage of location and site size trumps the developer's financial leverage. Furthermore, such transactions have few "what ifs." The zoning, cost of development, and future occupant are determined in advance and therefore construction and take out financing is generally in place. So, lastly and finally, rule #7: If you control a qualified hotel development site, you can forget rules 1 through 6!

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