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**Real Estate Joint Ventures -
Key Issues**

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General Topics

1. Economics
 - Contributions, distributions
2. Governance
 - Management, major decisions
3. Transferability/Exit
 - Limitations

Real Estate Joint Ventures - Key Drafting Issues

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- *Understanding the business deal, the players, and their expectations is critical to effective representation of your client.*
- *Anything the business people want can be achieved via drafting.*

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Capital Requirements

- Initial Contributions
- Additional Contributions
 - Who calls? What approval is required?
- Consequences for Failure to Fund
 - Notice and cure period
 - Default loans
 - To entity vs. to defaulting member
 - Ability to convert to capital contribution
 - Dilution
 - Impact on voting rights if <x%

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Distributions

- *NOT* a tax lawyer's problem
- Waterfall reflects priority of cash coming out
- Run sample scenarios to confirm language matches intent of parties
- Determination of reserves and available cash

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Distributions, cont.

- Generally, pro rata in accordance with percentage interests, with variations:
 - Guaranteed payments, default loans to JV
 - Return *of* capital
 - Return *on* capital
 - Preferred equity (equity-like)
 - Promote/carry structures
 - Distributions to operating member increase
 - IRR method of measuring returns takes into consideration time value of money

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Allocations

- Layer Cake

- Target

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Allocations

Layer Cake

5. Allocation of Net Income and Net Loss

A. After giving effect to the Regulatory Allocations set forth in [the special allocations Section (qualified income offset, Section 704(c) allocations, nonrecourse debt, etc.)] and subject to [the special allocations Section (qualified income offset, Section 704(c) allocations, nonrecourse debt, etc.)], Net Income or Net Loss for each Tax Year shall be allocated as follows:

(1) Any Net Income shall be allocated:

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Allocations

(i) First, to the Members, in an amount sufficient to reverse, without duplication, the cumulative amount of any Net Losses allocated to the Members in the current and all prior years, first pursuant to the proviso after Section 5.A(2)(iv), and second pursuant to Section 5.A(2)(iii), allocated to each Member in the reverse order and in proportion to the allocation of such Net Losses to such Member;

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Allocations

(ii) Second, to the Members, *pro rata* in accordance with their respective [percentages], until the aggregate Net Income allocated to the Members in the current and all prior years pursuant to this Section 5.A(1)(ii) equals the sum of (x) the unpaid Preferred Return plus (y) all distributions of Preferred Return previously made to such Members;

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Allocations

(iii) Third, (a) [X%] to the Members, *pro rata* in accordance with their respective [percentages] and (b) [Y%] to the Managing Member until the Managing Member has received in the current and all prior years allocations of Net Income under this Section 5.A(1)(iii)(b) equal to [carry percentage] of the cumulative allocations of Net Income of the Partnership made pursuant to Section 5.A(1)(ii) and made or being made pursuant to this Section 5.A(1)(iii) (taking into account allocated Net Losses reversing such Net Income), in the current and all prior years; and

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Allocations

(iv) Thereafter, all remaining Net Income shall be allocated (a) [100 minus carry percentage] to the Members, *pro rata* in accordance with their respective [percentages] and (b) [carry percentage] to the Managing Member.

(2) Any Net Losses shall be allocated:

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Allocations

- (i) First, (a) [100 minus carry percentage] to the Members, and (b) [carry percentage] to the Managing Member to reverse, without duplication, the cumulative amount of Net Income allocated under Section 5.A(1)(iv) in the current and all prior years allocated to the Members in the reverse order and in proportion to the allocation of such Net Income to the Members;

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Allocations

- (ii) Second, (a) [X%]¹ to the Members and (b) [Y%] to the Managing Member to reverse, without duplication, the cumulative amount of Net Income allocated under Section 5.A(1)(iii) in the current and all prior years allocated to the Members in the reverse order and in proportion to the allocation of such Net Income to the Members;

¹ These percentages match the catch up distribution percentages.

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Allocations

- (iii) Third, to the Members to reverse, without duplication, the cumulative amount of Net Income allocated under Section 5.A(1)(ii) in the current and all prior years allocated to the Members in the reverse order and in proportion to the allocation of such Net Income to the Members; and

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Allocations

(iv) Thereafter, all remaining Net Loss the Members, *pro rata* in accordance with their respective [percentages]:

provided, however, that Net Loss will not be allocated to any Member if such Net Loss would result in or increase an Adjusted Capital Account Deficit with respect to such Member, and any Net Loss that cannot be allocated to any Member as a result of this proviso shall be allocated first to the Capital Accounts of the other Members in proportion to the amounts allocable without causing or increasing an Adjusted Capital Account Deficit.

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Allocations

Layer Cake

Liquidation must be in accordance with Capital Accounts

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Allocations

Target

After making the special allocations provided in Section [] Net Income and Net Losses (and, if necessary, individual items of gross income and loss) shall be allocated, for each taxable year in a manner such that, after such allocations have been made, the balance of each Member's Capital Account shall, to the extent possible, be equal to an amount that would be distributed to such Member if

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Allocations

Target (cont'd)

(a) the LLC were to sell the assets of the LLC for their Carrying Values, (b) all LLC liabilities were satisfied (limited with respect to each nonrecourse liability to the book values of the assets securing such liability), (c) the LLC were to distribute all amounts available for distribution to Members pursuant to the appropriate provision of the [Cash Distributions Section] of the LLC Agreement, and (d) the LLC were to dissolve pursuant to the [Dissolution Section] below.

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Allocations

Target (cont'd)

The intent of the foregoing provision is to allocate Net Income and Net Losses (and, if necessary, individual items of gross income and loss) among the Capital Accounts of the Members in a manner that as closely as possible give economic effect to the [Cash Distributions Section] of the LLC Agreement and the [Liquidation Section], and shall be interpreted consistently therewith.

- Liquidation is in accordance with the Cash Distributions Section

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Tax Distributions

Tax Distributions. Notwithstanding the foregoing provisions of this [Distributions Provisions], the LLC shall make special distributions to the Members (“**Tax Distributions**”) to enable them to satisfy their federal, state and local income tax obligations arising from taxable income and gain allocated to them during a taxable year; provided, however, the LLC shall only make Tax Distributions if and to the extent that the amount of Distributable Cash distributed by the LLC to the Members for the taxable year is less than the Tax Distribution amount.

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Tax Distributions

Tax Distributions for any year shall be made to each Member based on the amount of taxable income allocated to such Member in that year and shall be deemed, to the extent made, to be an advance against and shall reduce future distributions to the Member. The amount of any Tax Distribution for any taxable year shall equal the product of (x) the net taxable income allocated by the LLC to the Member for that year and (y) the highest combined marginal federal, state and local income tax rate applicable to an individual resident to the state where the Project is located, taking into account the character of taxable income allocated and including, if applicable, the 3.8% tax on net investment income under Code Section 1411.

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New Partnership Audit Rules

- Partnership/LLC liable for tax assessed on audit, not Members absent, special elections
- Generally applies to all Partnerships/LLCs that have an entity as a member or that have more than 100 Partners
- Partnership Representative and Designated Individual
- Push Out Election
- Pull In Election

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New Partnership Audit Rules

- Amended Returns
- Contractual Issues
 - Member participation in audits
 - Indemnities of Partnership Representative and Designated Individual

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Governance

- Day-to-Day Management
- Major Decisions
 - Generally heavily negotiated
 - Manager wants broad authority and ability to act
 - Investor wants adequate say
 - Capital calls, sale, budget, financing, affiliate contracts, amendments, admission of transferee, bankruptcy, material contracts, litigation
- Budget and Business Plans

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Governance, cont.

- Dispute Resolution
 - Mediation, arbitration, coin flip, other tie breaker
- Remedies for Breach
 - Termination for cause
 - Self-dealing, fraud, misrepresentation, failure to perform
 - Dilution; forfeiture of promote
 - Impact on voting rights
 - Buy-sell provisions

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Transfers

- Allow for certain affiliate transfers
 - Must define “Affiliate”
 - May still require limits
 - Change of control
 - Key persons
- Lock-out period
- Transfers to non-affiliates must meet certain criteria (financial status, expertise)
- Transfer Tax Considerations

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Other Transfer/Exit Provisions

- Right of First Offer (ROFO)
- Right of First Refusal (ROFR)
- Tag Along Rights
- Drag Along Provision
- Put-Call
- Buy-Sell

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