OAK INVESTMENT MANAGEMENT GROUP

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Joint Ventures in Real Estate

Joint ventures (JVs) in real estate are when two or more distinct entities join together to bring a real estate proposition to fruition. Valuable considerations of a JV are that this approach does not merge the corporate identities of the companies concerned; it adds bandwidth to the size of the investment that can be safely looked at; and thus offers a form of risk diversification.

There are challenges to joint ventures in real estate as well. Real estate requires clear lines of command. Decisions are not discrete but binomial – so require a clear roles and responsibilities. If a majority owner is passive and a minority is active then there needs to be a clear description of the professional expectations (as distinct from the ownership rights) of the active minority partner. Equally, a minority partner always requires some sort of enhanced privileges to stop their interests being subverted by a majority partner.

But the trickiest of all structures is an equal 50/50 JV. Whereas initial resources divide up easily enough decisions do not. This opens up the opportunity for a real estate project to be deadlocked in the event of differences of opinion, outlook or souring of relations between JV partners. Because of the sometimes illiquid nature of real estate (especially a partially completed development site) this situation can have a precipitous effect on value.

Some ways of mitigating against the pitfalls that can be expected in real estate JVs is to have 1) a defined investment strategy from the beginning, 2) an approved business plan with controlled goal posts, 3) a workable organisational structure, 4) scenario plans for diverse outcomes and 5) a good dispute resolution mechanism that is proactive and seeks to head off issues before they cascade out of control. It can be argued that this is what be required of any real estate project – but with JVs enhanced planning is required from the outset. Even if sometimes scenario planning gets a bit complicated, arcane and self-defeating the planning in itself might not be a bad thing and a useful investment discipline.

JVs can release a complimentary skill set and multiply the resources available to only one investor. But in order for this to work seamlessly there needs to be an acknowledgement that there are different aspects of real estate that one or the other party to the JV might be better at. The initial sourcing, the due diligence, the underwriting, the purchase, the capital structuring, (where appropriate) the development or the asset management at steady state, the asset disposal all are deliverables that are required for successful engagement in the real estate industry. As a result, it may be that these need to be jointly arrived at or delegated to one of the JV partners.

Again planning and according clear roles and responsibilities is the best way to get the most out of a JV in real estate. It ensures that there is a true dynamic underlying the economic one of a coalescence of interests and motivation to arrive at a common goal. The downturn has had a negative impact on the attractiveness of JVs for many real estate investors as the sudden destruction of values is a scenario that few predicted. But the popularity of the JV will return the market returns and the need for scale re-appears in this very capital-intensive industry.

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