Development JVs: Time for a 5-Point Inspection

05.05.20

As we continue to experience and adjust to the impact of COVID-19, real estate development projects are particularly vulnerable. Although the spectrum of concerns may vary among projects that are "in negotiation" versus those that are already "under construction" (as well as across different product classes – healthcare, multifamily, commercial, mixed use, industrial, etc.), several core issues are common to all. Whether you are a developer/sponsor or an investor/equity provider, now is the time to reexamine certain fundamental provisions within your development joint venture agreement (JVA), be it still in the drafting phase or already executed. The following highlights some of the key JVA provisions that should be part of that inspection and many of these considerations will prove to be intertwined as the joint venture (JV) reacts and responds to COVID-19.

1. ***Additional Capital Requirements.*** Development JVAs typically provide for additional capital calls to fund working capital deficiencies, budget overruns, and project emergencies (which may include loan default scenarios and unforeseen costs associated with force majeure events). If one of these scenarios arises, then further assessments must be made, such as: (i) who can trigger an additional capital call; (ii) whether investor approval may be required and at what voting threshold; (iii) whether there are any limitations with respect to timing/notice or the amount of capital that may be called; (iv) whether satisfaction of a capital call is mandatory or discretionary for the JV members; and (v) what options (remedies, other sources of capital, etc.) are available to the JV if a capital call is not fully or timely funded. In the context of COVID-19's impact on a project, the developer/sponsor's primary motivation will be to keep the project on track and moving forward, whereas the investor/equity provider will also be focused on assessing whether any additional invested capital will eventually be recouped, and with the originally projected return.

2. ***Decision-Making Authority.*** A well drafted development JVA should clearly delineate the scope of authority granted by the JV owners to the JV manager (typically an affiliate of the developer/sponsor). Although most JVAs generally defer to the manager, subject to a specific list of "major decisions" for which owner approval must first be obtained, some take the opposite approach (i.e., the manager is only authorized to take a specific list of actions, and all other JV decisions fall to the owners). In any event, it is critical to know where these lines are drawn and to also identify any potential grey areas. In the context of COVID-19's impact on a project, the developer/sponsor will be looking for a broad runway to exercise authority on behalf of the JV so that it can nimbly respond to the evolving demands of the crisis, whereas the investor/equity provider will want to know that it is being kept fully informed of all material developments that could potentially impact its investment in the JV (and that its negotiated approval rights are not being compromised or circumvented in the process).

3. ***Force Majeure.*** The concept of "force majeure" often represents a heavily negotiated term within most JVAs. Although the applicable definition can easily consume half a page of text, the essential meaning of the term (French for "superior force") is an event or effect that can be neither anticipated nor controlled. Regardless of its simplicity or complexity, the occurrence of a force majeure event can have a significant rippling effect on the JV and its members. For example, it may excuse a delay in performance by the sponsor/developer. However, that result may first require certain minimum efforts by the sponsor/developer and that result may also expire after a specified period of time. In the context of COVID-19's impact on a project, a threshold question will be whether the COVID-19 pandemic falls within the JVA's definition of force majeure (and one should not assume that to be the case). More detailed discussion of force majeure can be found here.

4. ***Amendments.*** In light of the concerns identified above, among others, there may now be compelling reasons to amend certain provisions within the JVA. For example, the parties may want to reset their approach to emergency capital requirements, revisit requirements relative to business plans and budgets, extend notice and cure periods, or even adopt provisions that specifically address COVID-19. If the JV members can mutually agree, then amendment authority becomes a moot point. However, if a consensus cannot be reached, then the JVA's amendment provisions must be examined to determine whether either JV member can unilaterally implement certain amendments and the applicable

approval threshold if unilateral action cannot be taken. In the context of COVID-19's impact on a project, timing may be critical, so another consideration is simply how quickly the necessary amendment documents can be drafted, finalized, and then put into effect.

5. ***Exits and Wind Down.*** Although the underlying development project will hopefully be able to weather the COVID-19 storm, all possible scenarios must now be put on the table, including end of life events for the JV. Accordingly, the JV members should initially assess their options for potentially exiting the JV. Within the JVA, these options may include takeout provisions between the JV members (buy-sells, put-calls, etc.), potential third party sales of JV interest (which may be further subject to rights of first refusal or first offer), and possible forced sales of the underlying project. The ability to remove the JV manager may also be an important assessment, for both the developer/sponsor and the investor/equity provider. In addition to individual exits, the JV members should secondarily assess their options for winding down the JV. This assessment involves identifying the applicable wind down triggering events, determining which parties are required to approve a JV wind down decision, and confirming the applicable approval threshold.

As a final note, the foregoing 5-point inspection of a JVA cannot be conducted in a vacuum. Rather, a variety of related documents and corresponding third party issues must also be considered. Such documents include project loan documents, development agreements, insurance policies, and applicable guaranties and other credit enhancements. These topics are beyond the scope of this article, but additional information can be found on our website.

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