LESSON 2 - JOINT VENTURE EQUITY – PART ONE

OPPORTUNISTIC FUNDS VS. JOINT VENTURE TRANSACTIONS

Opportunistic Funds vs. Joint Venture Transactions

There is a distinct and significant difference between a Fund Structure and a Joint Venture Structure. Some key points of differentiation are:

	Discretion	Promotes / Profits	Investors	Leverage	Crossed Promotes	Realization Timeline
Fund Structure	A Fund Structure has discretion to make investment decisions without approval from investors.	A typical fund promote structure is 1.5% management fee and 20% of the profits after a 9-10% hurdle.	A fund has a set group of investors.	A fund typically uses leverage, but must put all the assets of the fund up as collateral.	In a Fund Structure, the sponsor promotes (profits) are crossed, meaning that one bad deal can cause a loss of promote on the good transactions.	In a Fund Structure, the manager does not receive its promote until the last asset is liquidated.
Joint Venture Structure	A Joint Venture does not have discretion to make investment decisions without approval from investors.	A Joint Venture promote structure can vary dramatically. A typical Joint Venture structure might be: • 50bps Origination Fee • 1% Management Fee • 20% after a 10% Preferred Return • 30% After a 15% IRR • 40% After a 20% IRR	A Joint Venture will have different investors to each transaction.	A Joint Venture is typically leveraged at the asset level by project debt. In some cases the General Partner (sponsors) may have to guarantee the debt.	In a Joint Venture structure, promotes are not crossed, and each deal stands alone.	In a Joint Venture structure, the promote is paid out on a deal by deal basis, when that transaction is sold or refinanced.

JV EQUITY PARTNERS OVERVIEW

(UNDERSTANDING WHO THE PARTICIPANTS ARE)

Joint Venture Equity Partners

The General Partner

Also known as the sponsor. They are responsible for the day to day operations of the project and all decisions.

The success or failure of the project depends on the expertise of the General Partner.

Limited Partners

Passive investors with little or no say in the project’s day to day operations.

They are along for the ride.

Institutional Equity

The big money partner. Looks for co-investment from General Partner which may include investment from the Limited Partner.

JV "PARI PASU" EQUITY

- Joint Venture Equity is also known as "pari pasu" equity.
- "Even Steven" equity, which means that all of this equity is treated equally.
- One of the keys to a successful JV "pari pasu" venture is to have an alignment of interests.
- This is the key to the appropriate equity structure.

JV "PARI PASU" EQUITY

Due diligence is a must for all possible JV investors. Questions that should be considered:

1. How is the ownership structured?
2. Where is the sponsor risk? (Cash equity, personal guarantee, etc.)
3. Who has the upside potential? How is this shared?
4. Who has the downside risk? How is this shared?

JV PROFIT PARTICIPATION OVERVIEW

- The sponsor's co-investment
- Co-investment amount from the general partnerships
- General Partnership equity subordinates or is pari pasu with Institutional Equity
- Sponsor promote

JV EQUITY WATERFALL: FULL SACK VS. NORMAL STACK

FULL STACK

- **FIRST TRUST LENDER:** Interest
- **FIRST TRUST LENDER:** Principal
- **MEZZANINE LENDER:** Interest
- **MEZZANINE LENDER:** Principal
- **MEZZANINE LENDER:** Kicker / Participation
- **EQUITY PREFERRED RETURN**
- **EQUITY PRINCIPAL INVESTMENT**
- **PROFIT SPLIT FORMULA**

NORMAL STACK

- **FIRST TRUST LENDER:** Interest
- **FIRST TRUST LENDER:** Principal
- **EQUITY PREFERRED RETURN**
- **EQUITY PRINCIPAL INVESTMENT**
- **PROFIT SPLIT FORMULA**

- Straight Line Participation of Profit
- Look Back IRR
- Fixed Exit Fee
- IRR Waterfall

JV PROMOTE STRUCTURES

CURRENT PAY

With Current Pay, the project needs to have cash flow from the beginning. Usually, there would be a quarterly payout to the participants.

ACCRUAL PAY

With Accrual Pay, the return is not paid current. Instead a balance is built up and paid back before return of capital.