Pircher, Nichols & Meeks LLP

The Real Estate Law Firm

PIRCHER, NICHOLS & MEEKS LLP

CAL/UCLA REAL ESTATE JV MOCK NEGOTIATION
Friday, March 18, 2022 (12 noon PT to 5:00 p.m. PT)
(PHASE 3: 2019, 2022, etc.)

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I. EXPLANATION AND FORMAT FOR MOCK NEGOTIATION

These are the handout materials for a mock negotiation between an institutional investor and a local sponsor (operator/developer) who are discussing a letter of intent (LOI) to form a real estate joint venture (JV). Though used in many contexts, a JV is a common vehicle for a local sponsor who has identified a real estate investment opportunity to raise most (often 90–95%) of the necessary equity from a single investor, and an example of that scenario is contemplated here. (A typical alternative to raising equity from a single investor is syndicating equity from numerous investors, which creates a very different dynamic that is generally more favorable to the sponsor. And it is not uncommon for a real estate investment to include both a JV with an institutional investor for most of the equity, and a separate, earlier syndication by the investor for its equity and sometimes yet another syndication, at the same time or earlier, by the sponsor for its equity too!)

These materials are intended to provide: a brief outline of the basic elements of a JV; some negotiating tips; the background facts and deal terms of the potential JV acquisition that is the subject of this mock negotiation; a list of six issues to be negotiated; the relevant LOI provisions for each of those issues; identification of the teams and an explanation of the scoring; and the bios of our guest judges. The students should read these materials (and the background reading materials identified below, which are hyperlinked) in advance and be prepared to ask questions about what they don't understand. As indicated in Part VII, the students have been divided into two negotiating groups, one to represent the investor and one to represent the sponsor, and each group is divided into three teams with each team responsible for two issues. The agenda is as follows:

- A 15-minute introduction primarily devoted to a sample mock-negotiation.
- A 120-minute coaching session for each group with at least one PNM attorney in a separate room to answer questions and to go over some of the possible arguments to make against, and to expect from, the other group.
- A 5-minute break.
- A 130-minute negotiation session. The negotiation session will begin with brief remarks of the guest judges identified in Part VIII regarding their joint venture experience (roughly 10 minutes total); the remaining time will be devoted to the six issues identified in Part V, with up to 20 minutes allocated to each issue. For each issue, the investor team will state its position first, no more than ten minutes (in total) will be allocated to the negotiation of that issue (teams should manage their time accordingly), and then the remaining ten+ minutes will be allocated to commentary by the guest judges. The moderator will provide a 2-minute warning after 8 minutes of negotiation.
- A 30-minute reception during which the winning teams will be announced.

<u>Background Reading Materials</u>

<u>Issue 1 (Key Person)</u>

Jackson and Cauble, *Operator Ownership and Control Requirements in Real Estate Joint Venture*, to be published in The Practical Real Estate Lawyer (March 2022) PNM #13983330

<u>Issues 2 and 3 (Capital Calls)</u>

Scheinberg and MacCracken, *Capital Calls in a Real Estate Joint Venture*, to be published in The Practical Real Estate Lawyer (March 2022) PNM #13986099

<u>Issue 4 (Contribution Default Remedies)</u>

Carey, Guggenheim & Soejoto, *Contribution Default Remedies in a Real Estate Venture*, Business Entities (November/December 2013) PNM #13304600

<u>Issue 5 (Whole Dollar Hurdles)</u>

CAREY, REAL ESTATE VENTURES: FORMULATING AND INTERPRETING PROMOTE HURDLES AND DISTRIBUTION SPLITS §§ 1.10 AND 1.19.6 (ABA 2016) PNM #12181657

<u>Issue 6 (Fiduciary Duties)</u>

Altman/Maas/Maxwell, *Eliminating Fiduciary Duty Uncertainty: The Benefits of Effectively Modifying Fiduciary Duties in DE LLC Agreements*, Business Law Today (Feb 2013) PNM #8942603

II. BASIC ELEMENTS OF A JV[1]

A. What Do Members Put In?

1. Pre-Formation Costs
2. Capital Contributions[2]
3. Guaranties
4. Cost-Overrun Protection[3]
5. Services

B. What Do Members Take Out?

1. Distributions[4]
2. Fees

C. How Is It Managed?

1. Control: Affirmative vs. Negative
2. Authority: Implementation
3. Duties[5]
4. Removal
5. Non-Compete

D. How Does It End?

1. Sale of JV Interest to Other Member
2. Sale of JV Interest to Third Party
3. Sale of Assets to Third Party

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[1] These general categories cover most, but not all, aspects of a JV. Most significantly, they do not address tax and accounting matters. There may also be provisions (e.g., an obligation to bring new deals for the venture or a sister or affiliate entity) that are not always included, depending on the parties and their concerns. Finally, there may also be provisions that are required by one of the parties (e.g., ERISA restrictions) due to its own individual requirements.

[2] Four of the six issues for this negotiation relate, at least in part, to contributions: (1) key persons (where the capital, in the case of the sponsor, is coming from), (2) what capital is required, what capital is optional (discretionary), and who decides, (3) the consequences of unilateral (non-default) funding, and (4) the consequences of unilateral (default) funding.

[3] Cost-overrun protection may come up in the discussion of contributions; however, the participants should not get bogged down in this issue because it is discussed separately in another session.

[4] One of the issues in this session will be whole dollar hurdles, which are explained in the reading materials. As part of the whole dollar discussion, the parties may end up discussing soft hurdles, but should not get into any details because that subject is discussed in another session.

[5] The sixth issue for this session is fiduciary duties. Non-competes may come up, but they should not be discussed in any detail because they are covered in another session.

III. NEGOTIATION PROCESS*

A. Be Prepared

1. Have an agenda – the way an issue is framed often impacts the way it is resolved.

2. Have a clear understanding of the issues so you can explain them simply.

3. Anticipate the comments and concerns of your counterparty – be prepared to address the tougher issues where your counterparty may have what seems to be a fairer or more sensible position.

B. Create a Constructive Atmosphere (make it easier for your counterparty to make concessions you need)

1. Be respectful – don't talk down to or over your counterparty.

2. Be a good listener.

3. Be honest.

4. Admit your mistakes (this can be very disarming and establish trust).

C. Be Patient Without Belaboring Points

1. Take your time to make sure you cover what you want to cover – check your notes as you go.

2. Don't be pressured into making decisions you are not prepared to make.

3. You don't need to know all the answers – a bad answer is worse than no answer at all. If you are not sure, you can say you will think about it, or you will check with your boss, or something similar.

D. Other Negotiating Tips

1. When you get what you want, accept it and move on. Don't give your counterparty an opportunity to change his or her mind. If the context is appropriate, you may want to thank the opposing party for the concession.

2. Table issues when you are not making progress or discussions seem to be progressing in the wrong direction.

3. Tie concessions to a package deal that gives you a point or two.

* * *

* These are general suggestions, not all of which may be applicable to each of these single-issue, time-limited mock negotiations.

IV. BACKGROUND FACTS AND DEAL TERMS

A popular resort on the big island of Hawaii is having financial difficulties and barely generating sufficient revenue to pay its expenses. An established and well-known Hawaiian development company ("**Sponsor**") that has been in business for over 40 years has put together a deal to turn around the resort. The resort owners have agreed to sell the resort to Sponsor, and Sponsor is in discussions with a luxury hotel chain ("**Franchisor**") that is interested in branding the resort under a franchise agreement. Franchisor has already approved Sponsor's plans for a six- to twelve-month renovation (the "**Renovation**"), and Sponsor's plans for a possible expansion (the "**Expansion**") after the third year (if the resort achieves the projected occupancy and room rates) that would add 24 high-end bungalow hotel rooms along the more remote areas of the resort's beachfront. The sale contract provides for a long feasibility study period (the "**Study Period**") of 180 days due to some water issues, which had originally added considerable uncertainty to the transaction. As a result of the favorable outcome of the water issues and some recent development activities nearby since the date of the purchase contract, the contract price now appears to be substantially below market. Sponsor also anticipates a big spike in value after the Renovation because the resort was run down and is likely to demand much higher room rates when the Renovation is done. Consequently, there is a chance the project could yield a handsome profit and very high returns if it is sold shortly after the Renovation. Sponsor may not have the liquid assets to contribute any cash towards the cost of the Expansion; consequently, its business model assumes an early sale following the Renovation.

Only 45 days remain until the expiration of the Study Period, at which time Sponsor must either terminate the contract and get a refund of its initial $1 million deposit, or waive its termination right and increase its deposit by another $4 million, which will then be non-refundable (subject to limited closing conditions). Sponsor is therefore anxious to line up needed equity capital and mortgage financing. Sponsor is diligently pursuing a number of lenders. Sponsor has also contacted an institutional real estate investment firm ("**Investor**") that specializes in resort properties and has a reputation for getting deals done quickly. Investor expressed interest in the deal and agreed in principle to the following terms:

- Capital will be funded 90/10 by Investor/Sponsor, except that if the Expansion occurs, then any equity contributions required for the Expansion will be made 100% by Investor if Sponsor does not elect to fund its 10% share, in which event appropriate (non-punitive) adjustments will be made to the distribution waterfall.

- Subject to possible adjustment if the Expansion occurs, distributions will be made 90/10 until Investor achieves a 12% annual IRR, and when the 12% annual IRR has been achieved, distributions will be made 30% to Sponsor as a promote and 70% pro rata (90/10). However, the parties are still discussing Investor's request that it receive at least 1.6 times its investment (the "**Whole Dollar Hurdle**") before there are any promote distributions.

Investor has sent Sponsor a letter of intent (LOI) incorporating these terms. Sponsor was not happy with the LOI and has scheduled a ZOOM call with Investor to see if they can strike a deal. Sponsor's issues list is set forth in Part V of these materials. The relevant sections of Investor's LOI are set forth in Part VI of these materials.

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V. SPONSOR'S ISSUES LIST

Issue	Investor LOI Position	Sponsor Position
1. Key Persons	The Sponsor Key Persons must put in 100% of the Sponsor's capital contributions, control Sponsor and be actively involved in the Project.	The Sponsor parent entity must control Sponsor. No other ownership, control or individual activity requirements will apply.
2. Capital Contribution Requirements	Investor controls these decisions, except that the following will be discretionary: (1) contributions to fund a "**Refinancing Shortfall**" (i.e., if a refinancing is not sufficient to repay the refinanced loan) and (2) Sponsor's share of the costs of the Expansion not funded by the project financing. Sponsor will have an obligation to make non-discretionary capital calls once approved by Investor; and Investor will have the right, but not the obligation to make capital calls directly.	Budgeted capital and overruns *mandatory*; other capital required for project *discretionary*. Capital calls may be made by Sponsor without Investor approval.
3. Unilateral (Non-Default) Funding	If a Member provides 100% of a capital call (other than by reason of the other Member's default), then the Company Percentages will be adjusted pro rata with no penalty factor.	If one Member funds 100% of a discretionary capital call, then the Members will be deemed to have contributed 90/10 and the Funding Member will be deemed to have loaned the other Member its share at a market mortgage financing rate. However, if the Expansion occurs, then the Company Percentages will be recalculated immediately after the Expansion based on the relative amounts of distributions each Member would receive from a sale of the Property at its then appraised value immediately after the Expansion.
4. Contribution Default Remedies	The LOI addresses contribution default remedies only for Sponsor defaults. If a 25% per annum loan to the venture is not elected, the non-promote distribution sharing ratio (but not contribution sharing ratio) will be diluted based on relative shares of capital contributions with a 100% penalty factor applied to the total amount of the relevant capital call; promote percentages will be diluted proportionately.	Contribution default remedies will be reciprocal. Any default loan will be made to the defaulting member (in the amount of the defaulting member's share) and the rate will be 15%. Penalty will apply to the amount in default only. Penalty factor will be 50%. Capital sharing ratio will be diluted both for distribution and contribution purposes. There will be no dilution of promote distributions.
5. Whole Dollar Hurdle	All distributions are made in accordance with Company Percentages until investor has achieved a whole dollar hurdle of 160% (i.e., the hurdle to reach promote distributions will be the greater of (a) a 12% annual IRR hurdle and (b) a 1.6X whole dollar hurdle).	There will be no whole dollar hurdle. But the Property will not be sold without Investor's consent for four years.
6. Duties	Sponsor is a fiduciary to the venture.	There will be no fiduciary duties.

* * *

[FORM – PLEASE DUPLICATE**]**

VI. RELEVANT PROVISIONS FROM INVESTOR'S LOI

1.	**Key Persons**:	The key persons associated with Sponsor (to be identified in the JV Agreement) shall at all times, directly or indirectly, (1) contribute 100% of the capital contributions of Sponsor, (2) affirmatively control Sponsor, and (3) be actively involved in the activities of Sponsor and the Company.
2.	**Capital Calls**:	Capital contributions will be made 90% by Investor and 10% by Sponsor within 10 days after a capital call has been approved or delivered by Investor, except that any such capital calls for Expansion Costs will be made 100% by Investor (if Sponsor elects not to fund its share) and any such capital call for a Refinancing Shortfall shall be discretionary.
3.	**Unilateral (Non-Default) Funding**:	If one Member elects not to fund its share of a Refinancing Shortfall, then the other Member may fund the entire amount, in which event the Company Percentages shall be adjusted to equal the relative proportions of the total capital contributions made by each Member with no penalty factor. Similarly, if the Expansion occurs and Sponsor elects not to fund its share, then Sponsor's Company Percentage will be diluted proportionately based on its share of capital contributions with no penalty factor, and Investor's Company Percentage will be increased accordingly.
4.	**Contribution Default Remedies**:	If Sponsor fails to contribute its share of a capital call approved or made by Investor (other than for a Refinancing Shortfall), then (without limitation on its other rights and remedies) Investor may contribute the entire amount and treat it as (x) a loan to the Company earning 25% per annum, compounded monthly, or (y) an "**Adjustment Contribution**" resulting in dilution as follows. If Investor elects to make an Adjustment Contribution, then Investor's Company Percentage will be recalculated to equal the percentage equivalent to a fraction (a) the numerator of which equals the total contributions (excluding such Adjustment Contribution) made by Investor plus 200% of such Adjustment Contribution, and (b) the denominator of which equals the total contributions made by all Members. In the event Operator's Company Percentage is diluted, its promote percentage will be diluted proportionately; however, Sponsor's 10% contribution percentage will not be reduced.
5.	**Distributions**:	Distributions shall be made as follows: (1) first, 100% to the Members in accordance with their then respective Company Percentages until Investor has achieved the greater of its then 12% annual IRR hurdle and its then whole dollar hurdle (i.e., the amount by which (a) 160% of its total contributions exceeds (b) 100% of its total distributions); and (2) then 30% to Sponsor as promote and 70% to the Members pro rata in accordance with their then respective Company Percentages.
6.	**Duties**:	Sponsor will at all times act as a fiduciary and, without limitation on the foregoing, promote the best interests of the Company.

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VII. TEAMS AND SCORING

Investor Teams [Investor and Sponsor to be determined within a week after the Q&A]

Team A ([Cal/UCLA] Team x)
Business Student: ______________________ ______________________
Business Student: ______________________ ______________________
Law Student: ______________________ ______________________
Law Student: ______________________ ______________________

Team B ([Cal/UCLA] Team y)
Business Student: ______________________ ______________________
Business Student: ______________________ ______________________
Law Student: ______________________ ______________________
Law Student: ______________________ ______________________

Team C ([Cal/UCLA] Team z)
Business Student: ______________________ ______________________
Business Student: ______________________ ______________________
Law Student: ______________________ ______________________
Law Student: ______________________ ______________________

Sponsor Teams
Team D ([Cal/UCLA] Team s)
Business Student: ______________________ ______________________
Business Student: ______________________ ______________________
Law Student: ______________________ ______________________
Law Student: ______________________ ______________________

Team E ([Cal/UCLA] Team t)
Business Student: ______________________ ______________________
Business Student: ______________________ ______________________
Law Student: ______________________ ______________________
Law Student: ______________________ ______________________

Team F ([Cal/UCLA] Team u)
Business Student: ______________________ ______________________
Business Student: ______________________ ______________________
Law Student: ______________________ ______________________
Law Student: ______________________ ______________________

SCORING

Each of the judges will score the students by completing a scorecard in the form attached.

- The scores for each team (by each of the judges) will be added together to determine the winners.
- In case of a tie, the moderator will make the final decision.

Scorecard – Judge: _______________

Team	Issue/ Party	Score (0 to 10)
Team A	Key Persons/ Sponsor	
Team D	Key Persons/ Investor	
Team B	Capital Calls/ Sponsor	
Team E	Capital Calls/ Investor	
Team C	Unilateral (Non-Default) Funding/ Sponsor	
Team F	Unilateral (Non-Default) Funding/ Investor	
Team A	Contribution Default Remedies/ Sponsor	
Team E	Contribution Default Remedies/ Investor	
Team B	Whole Dollar Hurdle/ Sponsor	
Team F	Whole Dollar Hurdle/ Investor	
Team C	Duties/ Sponsor	
Team D	Duties/ Investor	

Scoring System: For each issue, each team should be graded with up to 10 points (with 10 being the highest possible score and 0 being the lowest possible score) taking into account each of the following factors:

- Understanding: The team's understanding and mastery of the subject matter. Did it appear to appreciate the real-world relevance of the issues?
- Presentation: The manner in which the team presents itself. Did it appear professional, prepared and organized? How did it handle points it was not prepared to address?
- Effectiveness: How effectively the team presented its position. Was it convincing?

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VIII. JUDGES' BIOS

George Carras

George Carras has been involved in real estate investment and finance for over 35 years. George is currently the managing member of Carras Partners, a real estate company he formed in 2019 in Bethesda, Maryland. Prior to that time, George has worked with many well-established real estate companies including JMB Realty Corporation (where he managed acquisition offices in Washington, D.C., Philadelphia, Miami, and Tampa and also was a senior portfolio manager), Heitman Financial (where he led East Coast acquisition activities), Blackstone Real Estate Advisors (where he was a managing director, partner, and investment committee member), and StonebridgeCarras, LLC (where he was a founding principal and co-managing member, and worked on a number of large scale, transformational mixed-use development projects, including the 2.6 million square foot development of Constitution Square, one of the largest developments in Washington, DC). He has been involved in numerous real estate joint ventures with substantial experience both as an institutional investor and as a local operator. George holds a Bachelor of Science from the University of Maryland and a Master of Business Administration from the Indiana University Graduate School of Business. He is a member of the Urban Land Institute (IOPC Green Council), the District of Columbia Building Industry Association, and the Economic Club of Washington, DC.

Olivia John

Olivia John is the founder and CEO of Osso, where she is responsible for the investment strategy and day-to-day management of the firm and serves as the chair of the Investment Committee. Before Osso, Olivia was a Managing Director on the Real Estate Acquisitions team at Blackstone, where she worked in the New York and London offices from 2007 to 2020. She previously led the firm's U.S. multifamily investing efforts (approximately $12 billion of acquisitions) and played a key role in the creation and expansion of LivCor, Blackstone's U.S. apartment portfolio company. Olivia graduated summa cum laude from The Wharton School at the University of Pennsylvania, where she received a BS in Economics and was a Joseph Wharton Scholar.

Marc Perrin

Marc Perrin is the founder and managing partner of The Roxborough Group, a privately held real estate investment firm headquartered in San Francisco. Prior to founding Roxborough in 2013, Marc was a managing director at Starwood Capital Group where he co-headed Starwood's U.S. real estate investing and was a member of the investment committee for Starwood's private funds and the external manager of Starwood's public mortgage REIT. Before Starwood, he was an investment banker at Salomon Brothers Inc in the real estate corporate finance group and he started his career working for Bramalea Limited, a large Canadian real estate developer. Both at Starwood and at The Roxborough Group, he has been involved in many joint venture transactions and although he has been primarily on the investor side, he also has experience on the sponsor side. He received his bachelor's degree from UC Berkeley and an M.B.A. from The Anderson School at UCLA. Marc is a policy advisory board member at the Fisher Center for Real Estate and Urban Economics at the University of California at Berkeley and a member of the Urban Land Institute where he was previously a trustee.

Patti Sinclair

Patti Sinclair's career bridges business and law in major real estate matters, many of which involved joint ventures, primarily on the sponsor side. Patti is presently Senior Advisor for Special Projects for Lincoln Property Company, where she is involved in a wide range of commercial and mixed-use development projects in California, Oregon and Washington. Previously, she was Co-President and General Counsel of Playa Capital Company, where she successfully managed the very complex process of obtaining and defending entitlements for the massive real estate development known as Playa Vista. She then led and managed the successful effort to sell the company. Playa Vista covers an area in excess of 1,000 acres, originally used by Howard Hughes for aircraft development, including the famed Spruce Goose. Playa Vista is now a model of successful mixed-use development. Prior to her employment with Playa Capital Company, she was a partner in the national law firm Latham & Watkins. She received her law degree from Harvard and is a member of the American College of Real Estate Lawyers.