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### Structuring Real Estate Joint Ventures, Part 1

Real estate investors work together all the time. More and more, we see combinations of brokers, money investors, contractors and other folks flipping or developing properties. As members of a real estate venture, these folks need a formal structure to govern their relationships within the venture. In this article, I hope to give you a brief but condensed outline of the issues to think about when forming joint ventures for real estate investments.

There are three key concepts in structuring your joint venture: control, splitting up the profits, and exit. First, you need to think about who will control the venture, including the votes needed to make decisions, and day-to-day operational control. Second, think about how you will split the profits of the venture, including how you compensate those members who contribute their time (for example, contractors). Third, think about your exit – before you enter any business relationship, you need to have your exit locked down.

In this Part 1, I will focus on the first two concepts: control and splitting up the profits. I will address the third concept, exit, in Part 2 which will be in my next newsletter.

One last introductory thought: You should always operate a joint venture through a legal entity, whether a corporation or an LLC. Without a legal entity, the members will be partners in a general partnership. A partnership is about the worst structure possible, because it makes all partners personally liable for the partnership's debts. Check out my website, matt dickstein.com, for some articles on this subject.

**Control.** The concept of control generally includes board / member voting, and veto rights.

*Voting Power.* Generally, you make decisions about projects and other matters based on a vote of members. In a corporation, this is done through the board of directors. It is very important that you think through who will be on the board and how the directors will get along and ultimately line up in voting coalitions. An LLC works about the same, except you

count member votes instead of director votes. LLCs also can have managers, who are given varying degrees of operational control.

*Veto Rights.* For specified operating decisions, the parties can require a certain percentage (e.g. 75% or 100%) of the votes. These decisions can include purchasing or selling properties; budgets; hiring contractors; salaries & bonuses; affiliate transactions; bringing in new members; distributions; loans; etc. Veto rights generally help minority owners, because a minority can use a veto right to block company action. This can lead to deadlock.

**Splitting up the Profits.** A venture throws off money in various ways, including the sale of properties, lease rentals, interest payments to lenders, compensation to contractors, and compensation to the venture's employees. You need to clearly provide for the splitting of profits among the members based on such factors as money invested, time and labor spent in fixing up properties, and time spent in management.

Remember that managing owners can siphon off substantial salaries and perks, but absent mandatory distributions, passive owners might get no return on their investment. Consider how salaries and related party contracts will pull pre-distribution income out of the venture. Also consider sweat equity for persons who provide labor to the venture.

I will send you Part 2 – structuring the exit for your joint venture – in my next newsletter. Exits are absolutely crucial in all business relationships. Please feel free to contact me if you want to discuss these topics more.

## Ideas

People seem not to see that their opinion of the world is also a confession of their character. –*Ralph Waldo Emerson.*

Perhaps Eliot Spitzer got it right when as Attorney General for New York he offered advice about political survival: "Never talk when you can nod, and never write when you can talk." One more thing: Never put it in e-mail.

We talk about ourselves as a free enterprise society. Yet in terms of the fundamental question of who owns the means of production in the corporate sector, we are 48 percent socialistic because the corporate tax is 48 percent. –*Milton Friedman (1978).*

## Funny Papers

Slaney phoned the maternity ward at the hospital. "Quick!" He said. "Send an ambulance, my wife is goin' to have a baby!" "Tell me, is this her first baby?" the intern asked. "No, this is her husband, Kevin, speakin'."

I went into a restaurant that had "breakfast anytime." I ordered french toast from the Renaissance. –*Steve Wright.*

A friend in need ... is a pest. – *Frank Sinatra.*

My wife and I had words, but I didn't get to use mine. –*Anonymous.*