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When Real Estate Joint Ventures Go Wrong

Joshua Stein Contributor

Real Estate

I write about commercial real estate negotiations, deals and legal issues.

Development site where the lender will reportedly foreclose on a joint venture with the adjacent church. [-] RANJAN SAMARAKONE

Recent news reports highlight the risks to a property owner of entering into a joint venture, even with a well known and successful developer.

In a typical joint venture, a property owner and a developer team up to create a limited liability company that will develop a project. The property owner contributes land to the joint venture. The developer contributes its expertise, and maybe some money. The developer goes out and finds a mortgage loan for the project, and the joint venture puts up all its property – the entire project, including the land – as collateral. Because the developer didn't have to pay any acquisition cost, it's easier to find financing. The finances of the project probably look better to the developer.

If the project goes well, the property owner probably makes more money than it might have through an outright sale of the land. But if the project goes badly, the lender will likely foreclose. In that case, the joint venture will lose everything it owns, including the project. That means the property owner will no longer own its land (because the property owner transferred it to the joint venture), not have any money in the bank from selling it, and end up with a worthless interest in a joint venture that just lost all its assets. Not a great outcome.

Marble Collegiate Church apparently entered into such a transaction with Ziel Feldman, a prominent New York City developer – very successful for many years – whose projects have more recently suffered from some stress, all according to press reports.

The church owned property next to its house of worship and wanted to see it developed. Instead of selling or ground leasing it, the church entered into a joint venture with Feldman. The joint venture direct or indirectly borrowed from a private lender called Vanbarton Group. The project got into trouble. Press reports said Vanbarton was getting ready to hold a foreclosure sale, which would wipe out the joint venture's entire interest in the project, including the church's interest in the project. At time of writing, it is unclear whether that sale actually happened, but the entire picture shows how joint ventures can go wrong.

For companies not in the real estate business – and particularly churches and other nonprofits with excess land – joint ventures can be very tempting. But the story of the Marble Collegiate Church serves as a reminder that joint ventures create risks that perhaps these sorts of players shouldn't be taking.

If they want to participate in a development project, they have a few options that are usually superior to a joint venture.

The easiest and simplest is to sell their land outright. That creates the risk of selling too cheap or selling to someone who can't close and instead litigates. But once it closes, it's done.

As a much more complicated and issue-rich option, the land owner can enter into a long-term ground lease with a developer, who finds a money partner, obtains a construction loan secured by a mortgage on just the developer's leasehold interest (not the land owner's interest as landlord), and then puts up a building. That structure forces the land owner to stick around, potentially for the duration of the lease, but the stream of rent will often have a value that far exceeds the purchase price the developer would have paid in an outright sale. If something goes wrong, litigation may ensue, but the land owner's risk of losing its property should stay rather low.

As another possibility, perhaps the parties can structure the joint venture so that if the developer fails, the developer loses its interest in the joint venture but the former land owner stays in the deal with whoever takes over the developer's position. That's a rather subtle and difficult negotiation, but it can be done.

Finally, the land owner might decide to act as its own developer, hiring a third party development manager to oversee the project. If the land owner has a nonprofit mission that it wants the development to serve, this last option may become particularly appealing. On the other hand, it puts the land owner directly into the real estate business, which might not be such a good thing regardless of the deal structure.

Joshua Stein

I help buyers, sellers, borrowers, lenders, tenants, property owners, and other commercial real estate market participants identify and achieve their business goals. To do that, I need to understand risk, security, numbers, value, financeability, flexibility, and exit strategy. Some legal issues matter a lot and many don't. It's important to know the difference. I write extensively on commercial real estate law and practice – over 300 articles and five books on leasing, lending, and other areas, with some emphasis on ground leases. I occasionally serve as an arbitrator or expert witness in complex real estate disputes. That lets me see how transactions go wrong. Often, the problems could have been avoided by keeping it simple and following the money, but everyone got sidetracked. As a Forbes contributor, I try to tell stories that teach worthwhile lessons for real estate deals. **Read Less**

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