

The Use of Joint Ventures in the Hotel Industry: The ABC's of JV's

A Panel Discussion presented by:

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Current Market Context

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Current Market Context

- Financial Crisis of 2008/2009 created seismic shift in credit markets and commercial real estate
- Property valuations are down by as much as 50% from 2007
- Limited commercial lending; highly restrictive terms and significantly lower LTV requirements (sometimes as high as 80% with mezz in 2007, down to 50% in 2010); increased equity requirements now 40-50% of purchase price
- Gap between bid/ask still exists
 - Buyers pricing on trailing 12 months
 - Sellers pricing on projected 12 months: holding out for more/better days
- Lodging industry is “first in, last out” of effects of financial crisis
- “In chaos there is profit”
- Many opportunistic investors are raising (and deploying!) pools of capital (\$250M-\$1B); performance of lodging REIT stocks up 18% in 2010 far outpaced other REITS.

Effects on Hotel Industry

- **Owner/Developer:** Inability to obtain funding; Inability to move forward with new Projects or Renovations; Inability to locate traditional sources of “co-risk takers.”
 - New alternatives of funding sources must be located by Owner/Developer.

- **Management Company:** Lack of new projects; Lack of ability on part of Owners/Developers to renovate; Lack of pipeline.
 - New avenues of project financing must be considered by management companies if market share is to be sustained and growth is to continue.

The Case for JVs

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The Case for JVs

- Alternative form of financing; allows investors to leverage available equity to meet new LTV requirements
- Allows investors to mitigate risk/exposure spreading leverage due to lack of commercially reasonable financing
- Key money from 3rd party managers and brands is no longer sufficient; operators and brands need to be more competitive
- Synergies between JV partners; brands now more willing to do one-off deals, especially internationally

Headlines

Headlines

***After the Financial Challenges of 2009, Jones Lang LaSalle Hotels
Forecasts a 30 to 40 Percent Increase in Global Hotel Deals-
Worldwide Transaction Levels Could Reach \$28 to \$30 billion in 2011***

Hotel Online, News for the Hospitality Executive (November 30, 2010)

***RockBridge Capital and Davidson Hotel Company, Through a Joint
Venture, to Open 379-room Sheraton Stamford Hotel,
Stamford, Connecticut***

Hotel Online, News for the Hospitality Executive (November 2, 2010)

***Rivals Unite and Form Coalition of Investors to
Purchase Sea Island for \$214.4 million***

Hotel Online, News for the Hospitality Executive (October 12, 2010)

Headlines

***Marriott and the Spanish Hotel Group AC Hotels
Sign Agreement to Manage and Franchise a New Lodging
Co-brand Across Europe and Latin America – AC by Marriott***

Hotel Online, News for the Hospitality Executive (October 7, 2010)

***AREA Property Partners, formerly Apollo Real Estate Advisors, and Hyatt
Undertaking a Multimillion Redevelopment of the 1,193-room Hyatt
Regency New Orleans, Shuttered Since Hurricane Katrina***

Hotel Online, News for the Hospitality Executive (July 9, 2010)

***Interstate Hotels & Resorts Signs Merger Agreement for
Acquisition by Hotel Acquisition Company, LLC Through a Joint Venture
Between Thayer Lodging Group and Jin Jiang Hotels for \$307 million***

Hotel Online, News for the Hospitality Executive (December 18, 2009)

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What we'll cover today ...

- ❑ Formation
- ❑ Operation/Management
- ❑ Capital Contributions
- ❑ Distributions: Allocations of Profit and Loss
- ❑ Books and Records of Accounts
- ❑ Assignability of Interest; Addition of New Members
- ❑ Dispute Resolution; Dissolution and Termination
- ❑ Special Provisions

Formation

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Formation

- Choice of Entity
 - LP, LLC, C-corp.
 - Tax and local law considerations

- Structure
 - Simple JV
 - JV within a JV
 - International/Cross Border
 - REIT

- Multiple Classes (Class A, Class B, etc.)

Operation / Management

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Operation/Management

- Management of JV Entity – Designate Managing Member/GP
 - Services of Managing Member (compensation?)
 - Daily Decisions
 - Major Decisions
 - Majority vote (by number or %)
 - Super majority – 80% (terminate management contract or franchise agreement)
 - Unanimous consent
 - Sale of company or primary asset, refinancing, admission of new member
 - Required abstentions

Operation/Management

- Limitations on Members
 - Non-compete/AOP

- Transactions with Affiliates
 - Management Agreements

- Asset Management Liability and Indemnification of JV Members
 - Credit-worthy entity vs. “empty bag”
 - Guaranty
 - Parent entity
 - Personal

Capital Contributions

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Capital Contributions

- **Mandatory Capital Contributions**
 - Equity Contribution
 - Deemed Contribution

- **Additional Capital Contributions (capital calls)**
 - Non-contributing member dilution
 - “Squeeze down” – punitive
 - Contributing member loans/preference treatment

- **Capital Accounts**

Distributions: Allocations of Profit and Loss

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- Distributions
 - Waterfall
 - Profits % vs. Equity % = “promote”
 - Pro rata vs. pari passu

- Allocations (Tax Counsel!)
 - Net Profit and Net Losses
 - Allocation Matters
 - Special Tax Allocations and Elections
 - Transfers

Books and Records of Accounts

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Books and Records of Accounts

- Designate a member responsible for preparing/maintaining books and records or engaging accountant
 - Tax returns
 - Member access to same
 - Timing Considerations

- Set accounting basis and tax year

Books and Records of Accounts

- Designate tax matters member
 - Often GP or Managing Member
 - Capital Partner
 - Majority Equity Member often wants control

Assignability of Interest; Addition of New Members

Assignability of Interest; Addition of New Members

- Establish general conditions of transfer
 - Notice and consent of other members
 - When required: permitted vs. non-permitted transfers
 - Permitted: death of member, transfer to member affiliate
 - Non-permitted: sale/transfer of interest to 3rd party
 - See Special Provisions (ROFR/ROFO, PUT/CALL, Tag Along/Drag Along, etc.)
- Admission of new member
 - Consider effects on Operation/Management and Capital Accounts
 - Voting
 - Dilution

Dispute Resolution; Dissolution

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Dispute Resolution; Dissolution

- Arbitration/Mediation/Expert Opinion
- Events of Dissolution
- Distribution of Capital Contributions upon dissolution and liquidation
- Final Accounting

Special Provisions

Special Provisions

- ROFO/ROFR
- Put/Call
- Tag along/Drag along
- AOP/territorial restriction
- Assignability of Interest
- Amendment / Termination of material agreement with member affiliate (management agreement, asset management agreement, etc.)

Questions?

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