Devonshires

IT'S THE LAW: JOINT VENTURES

When two* become one

*or more

Time Goes By

Not so long-ago, Joint Ventures were seen as somewhat exotic. Something the 'big boys' (or girls) might consider, but only in limited situations. Nowadays, they're an integral part of the property development landscape. They are a tried and tested mechanism for increasing housing supply.

There's no precise, 'one size fits all' definition of 'Joint Venture'. The Oxford English Dictionary defines **Joint** (if you ignore the entry relating to cannabis) as '*sharing in a position, achievement or activity*' and **Venture** as 'a *risky or daring journey or undertaking*'. A more helpful description might be '*an arrangement between two or more participants who agree to cooperate and work together in order to achieve a common objective*'.

Tell me why

There are many different reasons why you might seek to establish a Joint Venture. In our experience the most common are…

It's a risky world and things are only likely to get riskier. A Joint Venture enables the risk of a project to be shared. So, if things don't pan out as you hope, at least you are not the only one carrying the can.

Size matters. All businesses have finite capacity, and that restricts the size of projects that they can be involved in. Joining forces with someone else enables capacity to be pooled and gives access to larger projects. That means that relatively smaller organisations can see the benefits of economies of scale and gives them the opportunity to operate on a bigger stage.

With our compliments. We see that quite different businesses coming together can often produce the most successful Joint Ventures. The secret is that they each bring different, but complementary, skills, resources and contacts to the table. In a mixed use project, for example, one venturer may be a whizz at operating commercial property but have little or no experience in building, renting and selling homes. The other venturer might be a Registered Provider who knows the residential sector inside out. On their own they are missing vital ingredients – but, together, they can fully participate in all the opportunities that a mixed use development might have.

Watch and Learn. Working with your Joint Venture partners will give you an insight into how they operate. Particularly if they are bringing to the table expertise in an area you are unfamiliar with, you will get to see how that expertise is deployed and you will learn from it. You will be able to deploy that knowledge throughout your business going forward.

Do it

Whilst the reasons to establish a Joint Venture may vary project by project, there are some fairly universal 'golden rules' to follow from the outset. Abiding by these rules won't guarantee success - but ignoring them will greatly increase the risk of heartache down the line.

Be aligned. Whilst bringing different skills to the table is a good thing, having wholly different cultures or objectives will likely end in tears. If one venturer only cares about maximising income in the first 5 years and the other is focussed on maximising the provision of low cost rental homes for the next century, there are likely to be stresses. Everyone is different, so some differences are inevitable, and that is fine. As long as they are acknowledged and addressed at the outset.

It's good to share. The most successful Joint Ventures usually see both parties sharing equally in cost, risk and reward. They may be putting in different things (from land, to money, to expertise) but if it ever feels to one venturer that they put in more than their fair share or they are getting out less than their fair share then, whatever the documents say, the Joint Venture is unlikely to thrive. Establishing a Joint Venture is not the time to 'win one over'.

Do your homework. It's important to spend time and effort to get to know what your prospective partners are like. You will only be able to be sure that you are aligned if you know them inside out.

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And remember, whilst it's important that you know and understand the people you deal with day to day, it's also vital to ensure that their business, as a whole, backs them and thinks the same way. Individuals come and go – and the people who are in the room when you sign may not be the people who are working alongside you in 5 years' time.

Do more homework. You are embarking on a long term business relationship with your Joint Venture partners. So you need to be happy that they will, in the corporate sense of the word, still be alive in the years to come. You need to be undertaking full financial due diligence. Well drafted Joint Venture arrangements will 'deal' with the scenario of one of the venturers becoming insolvent - but, however well drafted the document insolvency will lead to delay and cost and a world of pain. You'd be better avoiding partners who don't have healthy accounts in the first place.

Fail to Plan to Fail. A well drafted business plan is an essential foundation for most businesses – but it is even more fundamental for a Joint Venture. Developing a business plan before the Joint Venture arrangements are formally entered into is also a great way of establishing that the venturers' interests are, in fact, aligned. Before it's too late to call the whole thing off. If the process seems difficult or is proving too time consuming you've got to ask yourself: *are these people you want to lock yourself in with?*

Expect the Unexpected. Many risks will be apparent from the outset. Time should be spent identifying those and planning on how to deal with them. Appropriate mitigation measures should be put in place. But all parties to a long-term Joint Venture need to acknowledge that unexpected things will almost certainly happen. You need to make sure that you are content with that and have the confidence in your other venturers, and in the structure of the joint venture, to deal with them as they arise.

Go Go Go

There is no "one size fits all" type of Joint Venture structure. Essentially, however, they can be pigeonholed into two categories:

Joint Venture Vehicle (usually known as a 'corporate' Joint Venture): These involve setting up a separate legal entity (or vehicle) to hold the assets and operate the joint venture business. The entity will be owned and controlled by the venturers, who will become its members and will enter into a members' agreement to govern the operation of the new entity. The entity might be a company or a Limited Liability Partnership or, less frequently, what's known as a Limited Partnership.

Contractual Joint Venture: These don't involve setting up a separate entity. Each party usually continues to hold its relevant assets. The terms governing each venturers' respective duties, what they take out and how they reach decisions between themselves is set out in a contract between the parties. These types of Joint Venture include 'old fashioned' general partnerships.

We've talked about three different types of partnership there. For the purposes of this note all you need to know is that the law is such that a Limited Liability Partnership and a Limited Partnership are treated as separate entities in their own right and a general partnership is just a group of people working together. If you want to know more, get in touch.

Making your mind up

Which type of Joint Venture is right will depend on both the nature, scale and anticipated duration of the business to be operated, the purpose and goals and the requirements of the venturers themselves.

Joint Venture Vehicle: Setting up a new entity, such as a company or LLP, whilst not overly cumbersome these days, does involve a degree of red tape. Papers will need to be prepared and filed, fees will need to be paid, annual accounts will need to be prepared, audited and sent to Companies House (meaning they will become public). Company books will need to be kept and tax returns will need to be prepared. Tax may need to be paid (unless you have chosen an LLP to be the vehicle). You will need to check your existing arrangements with your banks to see if you need their consent to the setting up of the new entity.

On the upside though, the establishment and ongoing operation of a separate entity will impose a degree of discipline and transparency. The venturers will have the benefit of limited liability. So, unless guarantees have been given by the venturers, if the joint venture business is a failure and makes a loss the worst case is that the entity becomes insolvent and is wound up and the venturers lose what they put in. If one venturer wants to exit the Joint Venture, or if both venturers want to bring in a third, that is usually, from a legal perspective, a simple process (for example the transfer of shares in a limited company, if that is the type of entity established). Similarly, if third party funding is to be made available (with associated security) then this can be structured, and ring-fenced, more easily through the use of a separate legal vehicle.

The balance of pros and cons tends to mean that the 'vehicular option' is more suited to larger, more complex, longer term ventures.

Contractual: Entering into a contractual joint venture is simpler. It just means you are entering into a contract with the other joint venturers. The contract will cover:

- What each party is contributing to the venture and when (e.g. land, money or services)
- What level of control each party has over the venture and how decisions are made
- How the outputs will be shared (e.g. profit, intellectual property or completed homes)

The simplicity is the primary advantage of this type of Joint Venture. There is a high degree of flexibility in terms of how to structure the documents – since it's just a contract. So as long as you don't seek to do anything unlawful it's pretty much up to the parties what they agree. This type of Joint Venture is said to be 'tax transparent' since there is no Joint Venture entity which has to pay tax in its own right. The only type of vehicular option with that benefit is the LLP.

However, because no separate Joint Venture entity is formed, the 'project' will not benefit from limited liability or from being ring-fenced from other projects.

Contractual Joint Ventures are generally seen to be most suitable for relatively short term, single projects where there will be little requirement to adapt over time.

The tiny print

Find out more

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