INVESTING101 Joint ventures can leverage into high-priced city real estate, but caution the byword

Buying with a friend or family

Real estate has been top of mind for Vancouverites for quite a while now. After all, we live in a country, province and city that everybody wants to come to and live in. And it's expensive. So when people want to take advantage of this city's allure in terms of the rest of the world they think of owning and renting out real estate, having a tenant pay their mortgage and watching their investment appreciate.

One way of doing this is to pool your money with one or more friends to either make it happen in the first place or to purchase a more expensive (and hence more desirable and/or more profitable) property. Great idea but, if you establish a "JV" or "joint-venture" partnership to do this, what are the things that you should do up front in order to ensure that all goes smoothly and everyone is happy at the end of the day (and the deal)? So, you have found a property that interests you (for example, a duplex with rental suites), and your joint-venture partners agree. Now the hard part begins, as you must decide how to share in both expenses and potential profits.

The purchase can be structured as a share agreement with each member having a vote in any decisions. You also have to decide what happens if one partner wants to get out early. There may also be awkward discussions on what happens if someone can't come up with his or her share of expenses or any subsequent funding that may be required.

You will also have to decide on details such as what bank(s) and lawyer(s) to deal with and, of course, the timing and execution of the exit strategy. Any of these issues may lead to heated discussion, but it is best to get all these on the table before your money – and perhaps friendships – are at stake.

There are many different ways that these issues can be resolved but they must be dealt with right at the outset and hopefully with a consensus reached within the group

You will also have to decide on such things as what accounting method(s) you will employ and whether a member of the group can transfer his or her ownership to someone else, and the manner in which that will happen. You may wish to designate one person as the "manager" and allow him/her to write cheques and disburse funds; however most financial advisers rightly advise that you specify at least two signatures on any cheques that are written over a certain dollar amount. If you distribute periodic profits you will have to decide on how they will be disbursed. You can opt to keep them in the company/group or distribute them to the partners but if you opt for the latter, how will that be done? If you have disputes (and you will) what mechanism will you use to resolve them? (That should be in writing right from the start.) You must determine what jurisdiction's laws will apply to your agreement, whether your obligations will be several or joint (lawyers usually recommend several) and what to do if the partnership or JV becomes insolvent or if you are forced to wind it down for some other reason.

The bottom line is to get a good contract or corporate agreements lawyer to draw up for you an ironclad agreement that deals with every conceivable eventuality that could arise, because it's virtually guaranteed that at least one will.

Watch out

From a purely real estate-related perspective here are some things to look for and consider.

Firstly, what kind of property are you going to invest in? Will it be commercial or residential? They are two very different animals.

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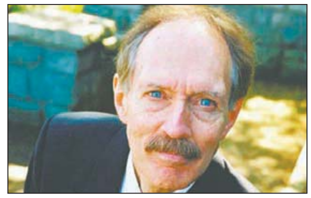

Neil Hamilton

Investment advice Neil Hamilton, property adviser
Target Investment real estate
Strategy Buying with partners, selling for a profit
Top advice Get everything in writing
Best case Stronger buying power, shared profit
Worst case Acrimony, insolvency and law suits

A residential lease is usually "gross," which means that you as the owner charge the tenant one single "gross" amount each month and all expenses related to the property are yours. A commercial lease is usually "triple-net," which means the tenant pays for the three basic operating expenses of taxes, insurance and maintenance. In this scenario the landlord charges two separate rents: the basic rent (the rent for the actual space itself) and the additional or triple-net rent, which covers the operating expenses of the property. Basic rent is generally negotiated up front on a pre-determined annual, square-foot basis over a multi-year term. The additional rent is also charged on an annual square-foot basis by the landlord, but for only one year at a time as each of the taxes, insurance and maintenance will usually change year to year (and these expenses must be justified).

Rental of residential and commercial properties is generally governed by different factors. The former is basically a place to live and the latter is a place to make money from an enterprise of some sort. Therefore, the renter's motivations for wanting that property are different. Rent increases are governed by different rules in both as well. In B.C., residential rents are limited by rent controls, but not commercial. These two markets also operate in different ways from a supply-and-demand perspective.

Pro forma

Put together an initial pro forma on the property. Based on your research, do the numbers work? Are you assuming things you shouldnt be assuming just because you "like" this property or really want to get going on *something*? Remember, in an investment you must be steely cold. Look at it with complete objectivity. Will this venture really work or are you just trying hard to convince yourselves that it will? Are you all in agreement one way or the other or do you already have divided opinions on the efficacy of this deal? Remember, a partnership is like a marriage. You must have compatibility among the partners or you will be doomed right from the outset. Have you brought in outside objective *professional* advisers to obtain their opinions on the venture?

Contract

A joint-venture partnership is a great way to multiply your buying power or simply allow a deal to come together that wouldn't otherwise materialize if you were attempting it on your own. But thousands of partnerships have ended in failure and acrimony. The main reasons for this are that the partners a) weren't compatible or b) a proper, ironclad agreement was never put in place right at the start to cover all eventualities. That is why it is imperative to know your partners intimately and to get a good contract lawyer (especially one that specializes in partnership and joint-venture agreements) to set up your deal. Investors who have this in place have a much better chance of success.◆

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Lower Mainland