REAL ESTATE LAW

Contributions to joint venture

Regarding land, cash partner should conduct complete due diligence investigation

BRETT SLOBIN

Oftentimes, two developers will jointly enter into a limited partnership or limited liability company (the entity) to develop multifamily housing on raw land.

Consistent with the formation of any entity to develop land, both developers initially will contribute cash to the entity. Cash would be contributed to the capital of the entity and accounted for by the entity as a credit to each contributing developer's capital account in the entity.

However, sometimes one of the developers already owns the land on which the development will take place, and the land-owning developer will contribute its land as that developer's initial contribution to the entity. In exchange for the contribution of the land to the entity, the land-contributing developer will receive a credit to its capital account in the entity.

What is one of the most significant concerns that the cash-contributing developer might have in becoming a joint owner of an entity that is accepting a contribution of land?

The cash-contributing developer must make certain that it treats the contribution of the land to the entity as if the entity were purchasing the land.

Prior to the formation of the entity, or at least prior to the contribution of the land to the entity, a complete due diligence, investigation of the land should be conducted.

For example, the cash-contributing developer should have a feasibility study period, which will provide the cash-contributing developer the right to conduct a thorough examination of the land. Such examination might include a market analysis of the land, an appraisal of the land to determine how much financing will be required, whether the amount of financing required for the land and construction of improvements on the land is available, environmental and soil investigations of the land, and investigations of any other relevant information to the land. Moreover, the cash-contributing developer will need time to conduct a title and survey examination of the land.

Furthermore, the cash-contributing developer should request representations and warranties from the land-contributing partner pertaining to the land's title, the authority of the land-contributing partner to contribute the land to the entity, the state of the land's environmental condition, as well as other customary representations and warranties.

All of the abovementioned issues can be included in the limited partnership agreement/limited liability company agreement (depending upon which form of entity is chosen), or in a separate contribution agreement between the cash-contribution developer and the land-contribution developer, or in a term sheet or letter of intent.

If the cash-contributing developer fails to conduct a feasibility study of the land, then the cash-contributing developer may end up becoming the partial owner of an entity that possesses a defective asset, which could result in the creation of substantial liability for the cash-contributing developer.

Brett Slobin is an attorney in the Houston law firm of Slobin & Slobin P.C., and he can be reached at bslobin@slobinlaw.com. His practice focuses on commercial and residential real estate. The information contained in this article is not intended as legal advice but to provide a general understanding of the law. Readers with legal problems, including those whose questions are addressed here, should consult attorneys for advice on their particular circumstances.

HOUSE HUNTING

Two homes heightens risks

DIAN HYMER

A couple had wanted to make a change for years. Like many people who want to make a move from the home they own to another they hope to own, this couple put the cart before the horse. They started by researching what it would cost to buy the next home before investigating how much cash they would net from the sale of their current home.

When they consulted with a local real estate agent about the probable sale price of their current home, they discovered it wouldn't sell for enough to enable them to afford what they envisioned. So, they delayed their relocation plans. They hoped the housing market would improve and their house would sell for more during the next year.

Unfortunately, the resale market in their area took a downturn, putting them farther away from their dream. Fortunately, however, they did not buy the dream home last year before selling their current home. This would have been a risky move financially.

House hunting tip: A risk of buying a new home before selling the current home is you may be inclined to base the list price of the home you're selling on what you need to sell for and not on what the market will bear. If you fall into this trap, you could end up listing at a price that's too high for the market. After months on the market with no offers, you'll have to drop your price to attract buyers' attention. You could end up selling for less than what your home would have sold for if it had been priced right for the market.

The couple mentioned above has decided to wait no longer for the market to give them a "go" sign. They are ready to get on with their lives. They have decided to sell their house now. It's impossible to time the real estate market, though it is possible to minimize your risk when buying or selling a home.

Another couple came close to making an offer on a home that was in a better school district. When they looked at the cost of carrying two homes, which was a likely prospect if they bought before selling, they decided against buying first. If their current home took a long time to sell or if it sold for less than anticipated, they could find themselves in debt.

Instead, they are planning to sell their current home first. If need be, they are prepared to rent until they can find a home to buy.

Unless you can afford to own two homes and verify a lender will qualify you to do so, you need to sell first or stay put.

Dian Hymer is author of "House Hunting, The Take-Along Workbook for Home Buyers" and "Starting Out, The Complete Home Buyer's Guide," Chronicle Books. Distributed by Inman News.

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