Reviewing Limited Partnership Agreements For Real Estate Funds

California Association of Public Retirement Systems

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Presented by

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Scott Smith is Senior Counsel with the San Francisco law firm of Hanson, Bridgett, Marcus, Vlahos & Rudy, LLP. Scott's practice emphasizes corporate, tax and real estate law. A majority of Scott's practice focuses on providing institutional investors with transactional, tax and fiduciary advice and counsel concerning their investment activities. Scott has assisted with the development, implementation and administration of investment programs for many of his clients. Scott's clients in this area have included two of the largest universities on the West Coast, Fortune 100 companies, large institutional clients -including 37 Act retirement systems- and tax exempt organizations. For these clients, Scott has reviewed and negotiated the terms of investments for over 35 different real estate funds. Scott has experience with both U.S. and offshore funds of virtually every type found on the market today, including venture capital, leveraged buy out, mezzanine, real estate, hedge funds and commodity pools. Scott has extensive knowledge of the "market" for these types of funds and has assisted numerous clients in obtaining the best investment terms possible while ensuring that sound investment policies and fiduciary obligations are observed.

Scott also has significant experience counseling corporations, partnerships, nonprofits and entrepreneurs in connection with all aspects and phases of their business and operations. Scott regularly advises clients regarding federal and state tax matters and his work often involves a complex tax planning component. In addition to working with institutional investors as described above, Scott has also sat on the other side of the table and represented venture capital, private equity, real estate and hedge funds in connection with fund formations and their investments.

Scott holds a BA in philosophy from California State University Fresno, a MA in International Relations from the University of Southern California, and a JD and a LLM (in taxation) from the University of Houston.

Key Points

- (Almost) Everything is Negotiable
- Aggressive Positions Are Often Taken By Funds
- Mistakes Are Made
- Review for Worst Case
- Need to Focus on the Details

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(Almost) Everything Is Negotiable

Negotiating

Weakness	Strength
Small Investment	Large Investment
Unknown Investor	Marquee Investor
Late Investment	Early Investment
Marquee Fund	Unknown Fund
Fund IV	Fund I
Fee Amounts (generally)	Calculation of Fees
Market Terms	Non-Market • existence of the provision altogether • terms of provision

Process of Negotiation

- Request, Receive and Review Everything
  - Documents to Request
  - Review Process
- Work with Advisors
- Talk with other Investors
- Negotiate Terms
  - Side Letters
  - Changes to Core Documents

Negotiation of Key Terms

- Most Favored Nation
- Strategy
- Investment Restrictions
- Conflicts of Interest
- Distributions
- Takedown Schedule
- Investor Liability
- Key Man Provisions
- Redemption
- Fees
- Preferred Return
- Carried Interest

Most Favored Nation

Allows investor to opt to receive any benefit/preference offered to another investor in a side letter or otherwise

Negotiation of Most Favored Nation Provisions

- Can apply regardless of investment amount or be limited to benefits/preferences offered to investors who have invested the same or a lesser amount
- Limited to benefits offered to similar investors, or benefits applicable to a particular investor, as determined by GP
- Application is automatic vs. requirement that investor affirmatively elect MFN treatment

Strategy

- Strategy outlined in offering materials should mirror strategy in organizational documents
- Watch for variance, broader authority in organizational documents—investing beyond real estate assets described, different types, different locations
- Watch for catch-all language
- Review closely in conjunction with investment restrictions

Investment Restrictions

- Asset types
- Asset locations- U.S., Non-U.S., Urban, Sub-urban
- Limit exposure to particular asset (i.e. no more than __% of fund in any single asset)
- Use of Leverage
- Investments in other funds/pools of assets

Conflicts of Interest

- Is GP managing other funds/accounts?
- What is GP's time commitment to this fund?
- Can GP form other funds? When?
- Dealing with affiliates at arms length?

Distributions

- Cash only
- Upon receipt
- Limit reserves to reasonable amounts
- No recycling/reinvestment
  - note, however, IRC 1031 and applicability to taxable investors

Takedown Schedule

- Prefer as-needed, just in time
- Over an ≈ 3 year investment schedule/term
- If not promptly invested: returned to LPs and/or investment income paid to LPs
- Default provisions: reasonable, notice and opportunity to cure

Investor Liability

- Limit to capital commitment
- Limit ability to recall distributions
  - Cap amount
  - Limit circumstances
  - Limit time frame
- No debt/leverage that's recourse to LPs

Key Man Provisions

- Focus on definitions of key man, trigger events
- Effect of trigger
  - Termination of investment period?
  - Reduction of fees?
  - Termination of fund?

Redemption

- Not typically allowed in real estate funds
- Investment is typically made for 7-10 year term of fund

Fees

- 1-2% Management Fee
- Other fees- acquisitions, dispositions, leasing
- Do they tapper over time?
- Do they cover all management expenses- double dipping?
- Are they reduced by fees from other sources?

Preferred Return

- Rate varies
- Typical: 8% of capital commitments

Carried Interest

- Typical: 20% of realized gains, after hurdle/pref
- Importance of clawback: carry should only be paid on cumulative fund wide gain