Platform Companies: An Evolution of Real Estate Joint Ventures

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The traditional real estate joint venture has long been a preferred model for bringing together deal sponsors and capital partners. Originally conceived as a one-off pairing of expertise and equity, the model has evolved to take on many forms. In the past several years, investors often partnered with sponsors in so-called co-GP and GP fund arrangements where investors share in the sponsor's general partner economics and associated risks. Perhaps the most recent trend in this evolution is the interest in forming jointly owned real estate platform companies.

In a platform company arrangement, a sponsor and one or more investors establish a new operating company as a platform company that often is designed to provide specialized management services to projects and assets. While the initial business plan for the platform company may be tied to servicing existing or future portfolios of the joint venture parties, the power of the platform company model lies in the potential for the new business venture to become valuable as an independent company. With roots in corporate private equity and venture capital, these platform companies bring a new and deeper element of intersection between commercial real estate and business.

Attractive Possibilities in Corporate Real Estate

Establishing a platform company introduces new and attractive possibilities for investors and sponsors alike. From a tactical perspective, a platform company arrangement may afford all participants the opportunity to make quick entry into niche or trending markets. More strategically, platform companies have the potential to become independently valuable. Structured appropriately, these companies may attract growth capital from venture or private equity sources. Investment in a platform company ultimately may lead to a lucrative sale, roll-up or other exit event.

For investors, platform company arrangements present opportunities for higher returns than traditional real estate joint ventures because they may be based on company valuation metrics (such as multiples of earnings) that are uncorrelated to real estate value. Institutional investors also may find these arrangements helpful in satisfying mandated asset allocations to real estate related private equity and venture capital. Some investors, including real estate private equity fund sponsors, may see opportunity in partnering with deal sponsors having specialized expertise rather than attempting to develop a new business line in-house.

For sponsors, platform companies and the equity capital they receive represent an opportunity to hire and scale operations quickly. This aspect may be particularly attractive to an emerging sponsor or entrepreneur. Sponsors also may see benefit in pursuing a higher risk or niche strategy through a separate dedicated company. Some sponsors may find greater success in attracting joint venture capital with the opportunity for enhanced returns through a platform company arrangement.

Watch Out for the Pitfalls

Platform company arrangements come with inherent conflicts of interest and other challenges that, if not managed well, will jeopardize success. Perhaps the most fundamental challenge requires reaching agreement on the nature of the relationship between sponsor and investor as it relates to ownership and governance of the platform company. There are a number of available models. Two of the more common (and diametrically opposed) approaches are the partnership model and the employment model. The partnership model would view sponsor and investor as more-or-less equivalent in rights – not necessarily equal in economic sharing percentages, but equivalent in fundamental decision-making and other non-economic rights. The employment model, on the other hand, would view the investor as the principal and controlling owner and the sponsor team as service providers.

Another critical area involves determining the permitted scope of the platform company business and navigating related conflicts of interest with both sponsor and investor. It is typical in these arrangements for the parties to address these conflicts through agreed exclusivity and non-competition terms. These types of conflicts and negotiated exclusivity and non-competition terms are not unique to platform company arrangements. Indeed, they are key elements of most real estate joint ventures. However, the potential independence and undefined duration of platform companies introduce an added layer of complexity to these discussions. Moreover, because these terms often uniquely burden the sponsor, it is important to consider from the sponsor’s perspective how these and other terms of the platform company arrangement may tie-up the sponsor on a long-term basis.

Finally, as with any emerging business construct, there are risks and inefficiencies to be borne by early adopters. Investors and sponsors with decades of experience in negotiating traditional real estate joint ventures may find themselves having to approach these transactions without the benefit of well-established institutional guidelines, market precedent or industry best practices.

Conclusion

There is no doubt that real estate joint venture structures are evolving to meet the demands of sponsors and investors. Market participants show increasing interest in entering into co-GP arrangements. The more recent arrival of platform company arrangements reflects a further evolution in this area and a further progression on the risk/reward continuum for joint venture parties. This trend also brings about a deeper convergence of commercial real estate and corporate deal terms and dynamics.