

PROJECT #1

Group #2

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I. ASSUMPTIONS

- A. Based on the nature of the investor's experience in real estate investment projects, and Professor Elmore's lack thereof, it can be assumed that the investors would want to maintain the same amount of individual control with limited liability within the company.
- B. From the above assumption, it can also be inferred that the investors would only be interested in a business type that leaves all the members to act as managers instead of a business type that only allows for a single managing member.
- C. Because the investors are foreign and plan to successfully obtain a non-recourse loan, it can be assumed that the investors have sufficient assets to secure desired loan type and that Professor Elmore should not have concerns about their financial standing. Additionally, because the parties are attempting to secure a non-recourse loan, it can be inferred the individuals are hoping to reduce and limit their individual liability as much as possible in the deal.

II. BUSINESS ENTITY STRUCTURE

- A. Based on the above assumptions and the nature of the existing and desired relationships between all parties, it is recommended to form a Limited Liability Company (LLC) to own and operate the real estate asset. With an LLC, all members have limited liability and there is no set duration for this type of company. Because this will be a multi-year project with all parties involved

wishing to have equal rights and responsibilities, an LLC is the best entity for the described project.

- B. The LLC is recommended to obtain insurance policies through the LLC and members should consult an attorney to obtain advice on the most helpful plan. Additionally, the LLC will be a member-managed LLC so that all members have the right to equal input into the project and to avoid securities law issues that could occur with a manager-managed LLC. If all members have equal participation, the investors do not act solely as shareholders in the LLC, but have the right to other roles and responsibilities as well.

III. DISADVANTAGES OF OTHER ENTITY STRUCTURES

- A. During the search for the most appropriate entity structure, many business types were considered. Each one was reviewed and passed on for the following reasons:

1. Limited Liability Partnership (LLP)

- a) Although seemingly similar to Limited Liability Companies, Limited Liability Partnerships have a twelve month renewable time restriction. Based on the analysis of the given conditions, it was decided that the yearly renewal period served as a risk for the group. Because this will most likely be a multi-year project, the yearly renewal period could provide a means to make the decision to exit the project easier for the investors, should something go wrong or the returns start slower than expected. Additionally, with an LLP, if one member decides to leave, the entire entity must be

dissolved and a new one must be created. There are also some states that do not recognize the LLP and could create issues for future projects should the group decide to move forward together.

2. Limited Partnership (LP)

- a) The Limited Partnership was a highly considered option with an LLC serving as the General Partner within the LP and the investors as the limited partners. However, it was decided that this was not the best option because it restricts the investors from maintaining any controlling power within the partnership. It was inferred that because of these reasons the investors would not want to participate in this entity type.

3. S-Corporation

- a) Because of restrictions to S-Corporations placed by the government, these entities cannot be made up of members that are non-domestic, meaning the foreign investors would not be able to participate in this business type.

4. General Partnership

- a) In a General Partnership, the general partner (presumably Professor Elmore) will not have not have liability protection and his personal assets could be at risk.
- b) In a General Partnership, investors might have little controlling power if an operating agreement specifies that one partner has

greater control (an agreement like this is not required). Since the members have not done business together, there could be a higher, unnecessary amount of risk involved with a General Partnership for this reason.

5. Joint Venture

- a) Joint ventures are only used once for one project which does not leave the opportunity for future investments without forming a new entity, which the group wishes to maintain the possibility of easy future opportunities.

IV. LIABILITY IMPLICATIONS

- A. With an LLC, all members in the company have a limited liability and are only directly, individually responsible for the initial investment, however permits the active participation of all members. Additionally, the group will be obtaining a non-recourse loan, which also decreases the individual liability.

V. TAX IMPLICATIONS

- A. With a LLC, the company may be subject to Franchise Tax due to the limited liability of its members, however, with the proposed BTCF of \$108,000 yearly, the LLC is below the \$1,130,000 threshold of the Franchise Tax so it should not be applicable to this company. Because this will be a pass-through tax entity, each member will be taxed on their individual income from the project as they would be normally, including the \$12,000 yearly management fee going to Professor Elmore, and will likely be taxed at the same rate as his income from teaching.

VI. BUSINESS MANAGEMENT IMPLICATIONS AND OPERATIONS DECISIONS

- A. Considering the scope of the proposed LLC, each member will maintain the right to be managing members, meaning each member can be involved in the day to day operations at any given point at their will. Because of this, it is strongly recommended that the company file an operating agreement with the Texas Secretary of State that outlines each member's individual rights with regard to management and operations, as well as any obligations for miscellaneous responsibilities associated with the project. Information about how each individual will be paid out from profits should be included as well as terms set out regarding capital calls should the need arise.
- B. It has been agreed upon that any withdrawals of cash will require the approval of both Professor Elmore and at least one of the investors.
- C. Currently, there is a management company that oversees the leasing and daily operations. However, Professor Elmore will act as a local presence and manager for the investor group. He will be allowed to make small decisions that fit within a scope that has been agreed upon by the entire membership group.
- D. The investors will use their real estate experience and act as advising managers.

VII. CONFLICT RESOLUTIONS - OPERATING AGREEMENT

- A. Since it proposed that the group file an operating agreement, the members will refer to the guidelines set forth by that document at any time should a conflict arise. The operating agreement should conform to the state specifications and contain all the necessary items including, but not limited to: financial obligations

and payout structure, responsibilities, rights to management and involvement, etc.

The operating agreement will be the reference for any and all disputes involving the project and should lead to smooth business operations considering all parties involved will have signed and agreed to that document.

VIII. REFERENCES

- A. Jacobus, C. J. (2013) *Texas Real Estate Law, Eleventh Edition*. Mason, Ohio: Cengage Learning.
- B. Sharpe, B. (Spring, 2019). *Note Outline* [Class handout]. College Station, TX: Texas A&M University, FINC 676
- C. Last, F. M. (2018, May 3). *S Corporations*. Retrieved from <https://www.irs.gov/businesses/small-businesses-self-employed/s-corporations>