

A Z

R E

ARIZONA COMMERCIAL REAL ESTATE

OFFICE MATES:

OBSOLESCENCE &
CONSTRUCTION IN A
SHIFTING MARKET

Inside:

DWELLING IN THE FUTURE

Multifamily sector
progresses

NAIOP ROUNDTABLE

Analysis of industrial,
office sectors

BALANCING ACTS

Inaugural
legislative update





MIXING THINGS UP

By AMANDA VENTURA

Too many cooks in the kitchen can spoil a soup, but with the right mix of experience, demand and legal advice, mixed-use developments can turn into a wildly successful, complementary group of projects.

Mixed-use developments are on the rise in Phoenix Metro as office buildings see the benefit of offering employees a place to work, shop, eat and seek entertainment in thriving community environments. To get one off the ground, though, requires a lot of collaboration and the clearing of many potential legal hurdles.

“The homeowner, the office tenant, the shopkeeper and the restaurant owner – each have concerns involving the layout, structure, location and function generally, including issues dealing with hours of operation, access (both pedestrian and vehicular), noise, security, costs, landscaping, utilities, insurance and so forth,” says James Connor, shareholder at Gallagher & Kennedy, P.A. “The various interests of the users may not always be aligned, and in fact, often may be in conflict.

“Creating the fundamental governing and controlling development agreements to serve all interests of the various users, while not undermining the value as an investment nor impeding the ability to obtain financing, is challenging,” Connor adds. “These agreements must deal with not only the development and construction periods, but of course, the indefinite life of the project for decades (if not longer) in duration.”

While drafting agreements that make everyone happy (enough) is key to the success

of a mixed-use development. The financing is perhaps one of the biggest non-starters.

“Because most developers have a goal of selling the project upon realization of stabilized cash flow, care must be provided to allow for each component to be able to be defined and conveyed, in order to market parcels to the strategic investors,” Connor says. “Put another way, a REIT which invests solely in office projects will have little appetite to acquire a parcel which includes retail, residential or other uses.”

Experts note that mixed-use projects are increasingly a response to less available land for new development in dense metropolitan areas.

“What makes a given mixed-use project unique depends to a significant extent on whether you are dealing with a ‘vertical’ or a ‘horizontal’ mixed-use project, and whether the project is being developed by a single developer or multiple developers,” says Mike Ripp, an attorney at Ryley Carlock & Applewhite.

Vertical projects, he says, are the most complicated type of mixed-use development.

“The uses are more physically interdependent on each other and that components on the lower floors may need to be in use before the upper floors are complete,” he says.

“The reason these projects are becoming more popular is because people like to live, work and play all in the same area. People like having access to these types of things,” says Nussbaum, Gillis & Dinner attorney Howard Weiss.

From a consumer standpoint, mixed-use developments make life easier. That said,



JEFF MOLOZNIK



MIKE RIPP



HOWARD WEISS

it's a long journey to the "parcelization scheme" that will grab investors, developers and tenants.

"As mixed-use projects become more prevalent nationally, it is likely that standard ways of handling the more common mixed-use project issues will evolve and gain acceptance," says Ripp.

"Some lenders find mixed-use projects difficult to evaluate because of the lack of real comparables," Ripp says, adding that underwriting the many components of development and being able to judge whether a developer has sufficient experience all the product types are also of concern to lenders.

Every single use at CityScape was financed independently of the others. It built a hotel, occupied it and then built apartments above. Instead of phases expanding horizontally, CityScape expanded vertically.

"The idea of having to vertically finance the phasing of a mixed-use project has been one of the most complicated things we've had to do here," says Jeff Moloznik, general manager of CityScape. "That part of it was far and away one of the most interesting and intricate elements of what happened," says Moloznik of the design and engineering work as well as the financing of the CityScape phases, which happened over a seven-year span.

Additionally, Weiss points out, discrepancy between parking ratios for the different components can sometimes occur. Another issue, he says, comes to leasing. As a tenant, he says, you may not have as much control over eliminating competition — for instance, being the only sub shop in the complex. Operating expenses, too, are important to define for the respective uses.

The expenses for elevators, cleaning and janitorial services or security are not always shared by all the tenants in a mixed-use development, he adds, citing the vertical and disjointed CityScape as an example.

"There's always an issue with the allocation of these expenses," says Weiss.

It is easier, he says, for projects such as Kierland or Scottsdale Waterfront, which have different components in different buildings — spread horizontally.

"In that type, from a legal perspective, you'll deal with reciprocal easement (REAs) and operational agreements," says Weiss.

That means that during development, if different components are owned or developed by separate companies, they can sign an agreement that allows for the most beneficial coexistence through contractual obligation.

"There are a lot of commercial leases out there, but at the end of the day a landlord wants a lease that specifically works with their project," says Weiss. "Because each one has a unique component, and depending on the developer, I would say this would be handled more on a case by case basis." ■■■

THE MOST COMMON MIXED-USE ISSUES

AND THE BEST WAYS TO OVERCOME THEM:

Developers: I see the developers as being the ringmasters in a multi-ringed circus; attempting to make everyone happy, despite the compromises in design, amenities, etc., which must be implemented. Issues which seem simple — say, parking — can become a Rubik's Cube. Residential users want sequestered and reserved parking, retail users want easy access and few restrictions on parking, and office users need both reserved and unreserved spaces, as well as ample parking spaces for visitors. Validation process for guests is an open item as well. The inherent conflict in these and similar goals makes the project challenging.

Investors: With few exceptions, most investors like the idea of the synergistic value which a mixed use project can provide, but do not want to own assets which have mixed and blended uses. So creating clear and discrete parcels, which isolate a use (e.g., hotel, etc.) within a mixed use project is important. Investors are also concerned to confirm that the allocation of operating costs within the mixed use project is reasonable, fair and predictable.

Designers: Mixed use projects present challenging building code issues, and require care in dealing the local municipal authorities. Often, "Life Safety" issues require considerable attention, given that the different "buildings" within a mixed use project will be interconnected, and therefore at variance with standard set back and separation standards. Fire escapes for "Building A" may be provided via corridors in "Building B". Also, providing for 3D perspectives is necessary given the conjoined nature of the overall project scheme. The CAD systems are utilized to their fullest capacity.

Contractors: As with any large scale commercial project, the contractors must make sense of the design and plans, and often face in the field challenges which were not previously envisioned. Phasing and scheduling are particularly difficult, along with maintaining safe and functional access throughout the project during the entire construction time period. Given the amount of time involved in pre-construction activities, a mixed use project does not readily lend itself to a bid process which commences at the completion of the design phase. Involvement of a general contractor during design seems to be the only practical approach.

Property managers/owners: Typically, a property manager for the entire project must be appointed, with clear powers and reporting responsibilities, and hopefully, there is a clear methodology set forth in the development documents as to sharing of costs, allocation of revenues (e.g., parking) and decision making for the various areas, including budgets, landscaping, insurance, maintenance, etc. Individual components within the mixed use project may have their own property managers, and frankly, engaging separate property managers for this purpose might be warranted.

—James Connor, a shareholder at Gallagher & Kennedy, P.A. For 30 years, he has represented local and national real estate developers, lenders and investors with commercial real estate matters including apartments, industrial, office and retail projects, master planned communities and shopping centers.



JAMES CONNOR