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Seminar 7

Mixed-Use or Mixed Blessing: Managing Operational Issues on Mixed-Use Projects

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Combining residential and non-residential uses, or retail and office uses, in a single development can present a developer and the end-users with many benefits. Developer benefits often include investment stability, density, flexibility with site constraints, and establishment of a captive consumer audience. End-user benefits often include residential affordability, a sense of community, and convenience to amenities. However, inserting different uses in a single integrated development has its potential pitfalls and management challenges. After a brief introduction to the concepts of mixed-use development, this paper will explore the good and the bad of horizontal and vertical mixed-use development, focusing on:

1. Economic Factors Affecting Mixed-Use Projects
2. Issues with Development of a Mixed-use Project
3. Governance and Management/Operational Issues with Mixed-Use Developments

I. What is Mixed-Use?

a. ICSC, NAIOP, BOMA, and the National Multi Housing Council agreed on the following uniform definition in 2006: "A mixed-use development is a real estate project with planned integration of some combination of retail, office, residential, hotel, recreation or other functions. It is pedestrian-oriented and contains elements of a live-work-play environment. It maximizes space usage, has amenities and architectural expression and tends to mitigate traffic and sprawl."

b. The Urban Land Institute characterizes mixed-use development as consisting of: (i) three or more significant revenue-producing uses (such as retail/entertainment, office, residential, hotel, and/or civic/cultural/recreation) that in well planned projects are mutually supporting; (ii) significant physical and functional integration of project components (and thus a relatively close-knit and intensive use of land), including uninterrupted pedestrian connections; and (iii) development in conformance with a coherent plan (that frequently stipulates the type and scale of uses, permitted densities, and related items). ULI further distinguishes between mixed-use development and what it refers to as “multi-use” development. Both include a variety of uses, but multi-use development lacks the integration, density, and compatibility of land uses required to create a walkable community with uninterrupted pedestrian connections between the various project components. Additionally, ULI specifies that mixed-use must include at least three integrated uses and each of

them must be substantial enough to attract a significant market in their own right; which excludes uses that simply serve as amenities for a primary use. ("Mixed-Use Development in Theory and Practice: Learning from Atlanta's Mixed Experiences", Joshua D. Herndon & Dr. William Drummond, May 5, 2011, available at https://smartech.gatech.edu/bitstream/handle/1853/40790/JoshuaHerndon_Mixed-Use%20Development%20in%20Theory%20and%20Practice.pdf)

c. In the mid-1980s to 1990s, in an effort to combat urban sprawl and retain metropolitan density, many US cities adopted policies with a focus on encouraging development of denser housing, concentrated and complimentary commercial space, and enhancing the character of neighborhoods. This led to much of the modern-day mixed-use developments that we enjoy (and struggle with) today. However, the latest surges of mixed-use development activity are not new concepts. They may now be writ large, but mixed-use development has existed at crossroads and in town squares for millennia. Consider the centuries-old inns, public houses, salons, taverns, gasthauses and pensiones of Europe that combined eating and drinking establishments with overnight guest rooms and other complimentary businesses, served as a de facto community center, and usually had a family or two living above or behind the commercial space. Early modern large-scale mixed-use developments include New York's Rockefeller Center, which was completed in the 1930s. Chicago's John Hancock Center was completed in 1969. Many world cities have mixed-use projects at their core. Over the years preceding the 1980s in the US, zoning codes acted to somewhat discourage the continuation of mixed-use development at times. Those zoning policies were based on the rationale that segregating land uses is warranted due to their frequent incompatibility. However, mixed-use development never went away. For an excellent in-depth study of the history, rationale, zoning considerations and data surrounding the topic of mixed-use development, with a focus on Seattle, WA, see "An Empirical Study of the Efficacy of Mixed-Use Development: The Seattle Experience", James R. DeLisle and Terry V. Grissom, 2011, available via https://www.NAIOP.org at: https://www.naiop.org/-/media/Research/Research/Research-Reports/An-Empirical-Study-of-the-Efficacy-of-Mixed-Use-Development/ARES-AnEmpiricalStudyoftheEfficacyofMixedUseDevelopment.ashx

II. Economic Factors Affecting Mixed-Use Projects

a. Achieving a proper mix of tenants is perhaps the most essential component to profitability of mixed-use developments. Planning and zoning officials across the US frequently push for mixed-use development for a variety of policy reasons, but a great location for apartments or offices does not always make for a great location for street-level retail. Following mixed-use demands of city officials often results in papered-over plate glass windows or low commercial rents. Each use within the mixed-use development must be able to succeed on its own in order for the project to be successful. Assuming your client has achieved a solid tenant mix in the right location, well-drafted governing documents and leases tailored to each discrete type of use within a development are essential to ensure ongoing economic success.

b. Consider the following factors that favor mixed-use development, as opposed to single use development:

i. Demand for mixed-use property is currently high among prospective tenants and residents, as urban and suburban populations across all ages seek a walkable active community with amenities like exercise facilities and coffee shops at their doorsteps. Mixed-use developments have a built-in customer base, but developers must carefully consider the scale of that customer base as compared to the scale of retail and restaurant uses.

ii. According to various brokers polled for this paper, office space within a mixed-use property often commands higher rents – as much as 30% higher than rents at stand-alone office buildings in the same market. Residential rents of highly-amenitized mixed-use properties also command a premium. High-paying office and residential tenants will have high expectations from the development. Consider co-tenancy requirements and other concessions that could be fairly given in such leases without putting the landlord at unnecessary risk.

iii. Diversity of investment across market sectors can provide stability in the event of economic downturns that disproportionately affect one asset class more than another. For example, multi-family asset values can increase at the same time that office and retail asset values

drop. Again, carefully consider giving/requiring tenant concessions like co-tenancy in this context.

iv. Certain public finance incentives may be more feasible (or more broadly useable) for mixed-use developments that have retail components. Many jurisdictions have incentives that come in the form of special taxing districts or tax increment financing that capture sales taxes that may be used to service debt for infrastructure and other public improvements. In such cases, sales taxes generated from the retail component of a mixed-use development may be used to offset the capital investment in the entire project.

c. Mixed-use development can also have economic downsides.

i. As discussed in more detail below, entitlements, financing, planning, development and construction are inherently more complex and costly. When asked to give a fee estimate on a mixed-use development, our experience is that one should overestimate.

ii. Outdated or poorly-tailored zoning requirements may result in project waste. Such projects have often resulted in excess parking facilities due to parking ratios that are not tailored to mixed-use development. Incorporating the proper amount of functional parking may also present major obstacles in project design. Variances to parking requirements and other flex-parking options should be explored with the project design professionals, as necessary. When done well, flex-parking among mixed uses can be an economic upside – costing less than parking for the individual uses would cost if they were not sharing parking.

iii. The specialized needs of variable uses requires careful planning and tenant mix that, when done poorly, will have a significantly negative impact on the asset's value. While diversity of investment across market sectors can provide stability, the mixed-use structure of a development carries substantial risk of going wrong.

iv. As discussed in more detail below, property operations and management can easily get convoluted and require specialized and experienced (i.e., expensive) staff. Property management agreements often arise as an after-thought in development planning, with the property manager's form of agreement acting as the starting point for negotiation (or acting as the first and final document without any negotiation). In mixed-use developments, the property manager's agreement(s) will require careful identification of each manager's scope of services, limit discretion on spending outside of the annual budget, and require cooperation among the varying components of the development. Diverse ownership of different assets within a mixed-use development significantly complicates property management and common area costs.

v. Lease-up may have a longer runway, and lenders may have stricter requirements for qualification of initial stabilization of the entire project. Loan documentation should be drafted to address the multiple uses that are covered by the loan collateral. Typical loan agreement covenants are often too broadly written in some areas, and too narrowly written in others, when applied to a multi-use asset.

vi. Unless one developer is spearheading the entire mixed-use development, cooperative agreements with co-developers are required. Co-development comes with its own inherent risks, including failures and shortcomings of components of the development that may be essential to the success of the whole. More on that concept below.

III. Issues with Development of a Mixed-use Project

a. The challenges with developing a mixed-use project vary depending upon whether there is just one developer or a cooperative team of independent and separately financed developers.

i. If a single developer, the development of the mixed-use project is only mildly complex because the entire project is under the control of a single part. Nevertheless, there remains one essential question in this context (and it is a hard one): Client do you know what you are doing? A skilled developer of one kind of project, say office, does not make a skilled

developer of other types of projects, say retail or hotel – and the learning curve can be very painful – or even fatal to the project.

ii. If the project is to have more than one developer, the complexities multiply with the increase in the number of the parties at the table. With just two developers involved, the number of stakeholders could be eight or more, such as:

1) Each developer of a component of the project.

2) The construction lender for each developer.

3) Possibly the LP investor for each developer.

4) Possibly a mezzanine lender for either or both of the developers.

With the addition of each developer party, the complexities grow exponentially.

iii. The best advice for the practitioner is to anticipate the complexities created by the introduction of multiple parties to the transaction and not fight it, because the "golden rule" will prevail as it always does. The best advice the practitioner can give to her client – which will not be well-received – is to budget much more than anticipated for legal fees, because the documentation will be extensive and thoroughly picked over.

b. Development issues in a Multi-Developer Mixed-Use Projects – Horizontal Mixed-Use.

i. Mixed-Use projects involving more than one developer are all complicated, but the horizontal developments are somewhat less involved than vertical mixed-use projects due to each use enjoying its own plot of land. Nonetheless, the horizontal mixed-use project presents challenges galore.

ii. Almost all mixed-use projects share some ***fundamental infrastructure***, such as roads and utilities and possibly parking, loading areas and other shared facilities. Shared facilities that do not yet exist require development and co-dependency between the parties.

iii. Therefore, the very first step in the shared development process, after the purchase and sale agreement, is to allocate responsibilities for infrastructure development and to provide assurances that each party will live up to its responsibilities. These rights and obligations are typically manifested in two important documents – the ***development agreement*** and ***the reciprocal easement agreement***.

iv. The development agreement sets forth the responsibilities relating to the creation of the essential infrastructure that allows the mixed components of the project to function. The responsibility for producing this infrastructure does not necessarily fall on the shoulders of a single developer, but almost certainly, the construction of each separate infrastructure component – roads, parking utilities – will almost certainly be a responsibility of one of the parties acting alone. Therefore, the parties must consider including each of the following in the development agreement, even if there is complete trust between the developers (because their lenders or equity investors will not share that trust):

1) Foremost, the scope of the work must be clearly described and agreed upon. This usually takes the form of an agreement to the ***plans and specifications*** for the project component to be developed, together with ***approval of the contractor*** selected to perform the work, as well as the terms of the ***construction contract***. A procedure for ***change orders*** must be agreed upon, and this could be contentious, particularly if one developer wants to limit the right of the other developer to submit change orders for approval. This becomes one of many reasons that the development agreement should contain an expedited dispute resolution provision such as ***arbitration***. It is important to keep in mind that plans change once field conditions are encountered, so a mechanism for dealing with change orders is essential. For the developer charged with completing the project, a safe harbor, such as for ***minor change orders*** and ***change orders dictated by governmental requirements*** is important. This is important because . . .

2) The development agreement will also include a ***construction schedule*** containing ***project milestones*** that must be met to give the non-developing party and its financiers confidence about the timely completion of the project. For the passive party, it provides little protection merely to set a completion deadline, as the consequences for missing the deadline could be catastrophic. For example, an anchor tenant likely will impose stiff penalties if opening of a facility is delayed. The project milestones provide an early warning system; if they are missed, then remedies ensue. A tight set of deadlines, however, is intolerable not only to the responsible developer, but also to its lender, making financing a challenge. Therefore, the following should be considered to strike an appropriate balance:

   a) The milestones should include a reasonable amount of "fluff" to give the parties comfort.

   b) The milestones should be postponed by the period of delay caused by force majeure or by the other party or its lender – but this protection should be tempered by a "no monkey business" clause, namely that a claim of permissible delay must be made within a set time after the cause of the delay happens.

   c) Appropriate provisions for notice and cure should be included so that a developer has the opportunity to bring the project back into reasonable schedule alignment.

   d) And since nothing ever goes as planned, and the developer must deliver according to the agreed schedule, it will want a deemed consent concept from the other developer and its lenders in order to avoid protracted delays attributable to changes in the anticipated course of action. Such a deemed consent concept could arise if there is no response after a second notice, something like the following:

      "THIS IS DEVELOPER'S SECOND REQUEST FOR APPROVAL OF A CHANGE ORDER. IF YOU DO NOT RESPOND TO THIS CHANGE ORDER REQUEST AS REQUIRED UNDER THE DEVELOPMENT AGREEMENT WITHIN THREE (3) BUSINESS DAYS, YOUR APPROVAL SHALL BE DEEMED GRANTED."

3) Of course, the development agreement must include approval of a ***project budget***, and as everyone knows, "blood is thicker than water, but money is thicker than either." Thus, the allocation of cost responsibilities is even more important than the total amount of the budget. Whether the parties share in the total cost based on some agreed percentage thereof or the non-performing developer's obligation is set at a fixed amount, the amount and scope of the budget is very important. Almost certainly, regardless of the base cost-sharing scenario, there will be an allocation of risk for cost overruns. The performing developer will likely bear the risk of "***controllable cost overruns***", at least up to a capped amount, but the parties will likely be obligated to share in "***non-controllable cost overruns***." Items that are not controllable include increases in the base rate of interest on financing, and increases in taxes and insurance (but in each case not if attributable to delays in achieving substantial completion of the project), costs attributable to force majeure events, and costs for which the general contractor is entitled additional compensation beyond its guaranteed maximum price, such as unbudgeted costs for concealed conditions. The developer who bears the risk of controllable cost overruns should also receive the benefit of cost savings. And the performing developer will seek flexibility to apply contingency (a percentage of completion approach likely is not acceptable, since contingency is disproportionately needed before the project gets out of the ground) and line item cost savings that can be demonstrated.

4) Once a budget is set and cost responsibilities allocated, the parties must focus on the basis for securing performance of the respective cost responsibilities. The security can take many forms, such as a letter of credit or a performance guaranty.

A very common means of securing the payment obligations is to create an ***escrow account*** controlled by an independent party, most likely a title company, from which costs would be paid much like under the terms of a construction loan agreement. Each party funds its obligation into the escrow account up front, and then draws are made monthly upon presentation and approval by the parties of the draw request. This would include applications for payment, lien waivers, certifications from the project engineer and possibly a ***construction inspector***, title date downs and budget updating and balancing. Draws would have to be submitted to and approved by the lenders for both the performing and the non-performing developers. Escrows have the distinct advantage of placing the needed capital directly into an account for use in the construction process, but they also carry the distinct disadvantage of adding interest cost during construction.

5) If the developer falls off schedule or commits some other default under the development agreement, and the default of whatever nature is not cured within any permitted grace period, then the other developer – and the lenders for both developers – will have ***step-in rights*** to complete the work, using the escrowed funds and otherwise at the expense of the defaulting developer. Because of the severe ramifications of such a remedy, it is the focus of intense negotiation. Neither the developer nor its lender wants to lose control of the process and face unplanned cost increases. But no party will tolerate unacceptable project delays or funding failures. Therefore, the step-in rights are inevitable. The process is much like that of a lender taking over an asset, except that the construction is ongoing, and in this instance, there are multiple stakeholders – each developer and each of their financing sources. ***Collateral assignments of contracts and permits*** may be a part of the development agreement, so that the party stepping in has the right to assume control of the project. The sequencing of step-in rights is also important, i.e., which stakeholder goes first and which of the others then stands in line next? If the non-performing developer is willing to take over the project, it is likely that the lenders will permit this, as lending entities are not developers. But the party stepping in assumes the obligation to complete the project as required and would be subject to further step-in rights of the lenders. As for the relative rights and obligations of the lenders, an ***intercreditor agreement*** will almost certainly be required.

v. The second key document in the development process is the reciprocal easement agreement (or "***REA***"). While the development agreement is temporal in nature, the REA is permanent, for the most part. The grant of easements for access, utilities, parking, signage, storm water detention and other project needs, using the improvements developed pursuant to the development agreement, is essential. Easement rights are powerful rights and, while not fee simple title, they carry a lot of weight and importance. The scope and definition of the easements and their priority over financing liens is an essential part of the mixed-use development process. While the definition of the easement rights is relatively uncontroversial (with the exception of parking rights), the responsibilities of the parties for the maintenance and expense related to such shared facilities, and the control thereof, are matters of intense negotiation. These issues are addressed later in this paper.

1) Parking is ultimately a management and operational concern, but ***shared parking*** is worthy of some discussion in the context of the REA, because those rights, as required by different types of uses, are not always compatible. Retail deplores "parking hogs" (parkers who take up spaces for extend time without engaging in shopping at the stores), and office parkers are just such "parking hogs." And office parkers require convenient parking, and typically arrive well before the retail stores open. And residential has a completely different set of needs, as does hospitality. The good news is that high demand for residential and hotel parking is at night, when demand for office and retail is low, so redundancy is a true opportunity for cost savings. But the residential occupant must have a space when she wants it, and in a condominium setting likely will require a reserved space protected by controlled access. Similarly, the hotel operator needs convenient reserved spaces for valet parking in addition to unreserved self-parking spaces. The legal documentation of these respective rights is dictated by the parking field layout and

demands of the respective users. Whenever there is redundancy, there is a need for some measure of control in terms of the number of spaces that can be used at any given time. Often, conflicting demands are met by establishing restricted fields for a base number of spaces required by the respective users, with the balance of the parking being left to "first come, first served," with the parties agreeing to revisit if the arrangement is not working in practice.

c. Development issues in a Multi-Developer Mixed-Use Projects – Vertical Mixed-Use.

i. A vertical mixed-use project faces most if not all of the development challenges of the horizontal mixed-use project, but many are considerably more intense given the vertical nature of the project.

ii. The base issue, literally, is the ***podium*** upon which each component of the project will be based. The podium contains fundamental structural elements, parking, operating systems, and entry drives, plazas and other features at street level. The easement considerations are involved, as well as the development responsibilities. And fire code and other regulations can complicate the ownership structure, requiring that the podium parking be owned by one party or the other, with easement rights and cost-sharing obligations. The process described above for assuring proper and timely development and appropriate easement rights applies to the podium, but issues such as construction timing and inspection are considerably more important, and fire code issues are unique. The non-performing developer has likely secured financing for the construction of its component of the project, as well as a lead tenant or tenants, whose occupancy deadlines must be met. The developer cannot begin any work on-site until the podium is completed.

iii. With respect to the improvements above the podium, the development issue is whether the vertical building shell will be completed by a single developer or in part by one developer or the other. In a development with twin towers (such as one for office and one for residential), the issue is simple, as each developer will perform the work for its project. Of course, the easement agreement (or condominium declaration) will need to address coordination of construction activities so that work proceeds on both projects in a compatible way. Moreover, if the projects are not completed simultaneously, the documents will dictate construction rules so that the occupants of the occupied components of the mixed-use project are not unreasonably disturbed by the ongoing construction activities for the other components.

iv. If the mixed-uses to be owned by different developers are stacked one on top of the other, the development responsibilities are more complex. If the driving force of the project to high-rise office or residential, the developer of that component may also complete the shell of the retail at street level in accordance with plans approved by the retail developer. The processes described above for horizontal mixed-use would apply, with the added wrinkle that ownership of the retail almost certainly would remain with the high-rise developer until the project can qualify for condominium ownership. In such a scenario, the retail would be "pre-sold" to the retail developer, with closing taking place upon completion of building construction and the filing of the condominium documents.

v. If, however, the driving force of the development is retail, then it is far less likely that the retail developer will either release the development responsibilities to the high-rise owner or agree to complete the high-rise component in a "pre-sale" transaction (as the cost exposure is too great). Therefore, a bifurcated development process would be required, and this is considerably more complicated. In short, the retail developer has to complete the retail component, including the structural rebar and other elements so that the high-rise developer may take over the remaining portion of the project thereafter. But then the development and financing complications abound. What if the high-rise developer does not complete its work? What if the construction of the high-rise component results in liens being filed on the property? How to handle insurance? Will there be one or two lenders, and if more than one, how is the collateral allocated? If a single lender, how is a non-defaulting borrower protected from a default of the other borrower? Is a conveyance of air rights the solution? If so, when does the conveyance occur, and how are lien rights from ongoing construction addressed? Do the two developers form a joint venture to own the entire project during construction and then redeem out the interest of one of the venturers upon

shell completion by conveying title to the portion of the project to be owned by that party? All solutions are admittedly complex.

vi. Upon completion of the shell construction, the project may be split into two or more components for separate ownership, using either air rights or condominium regime. Either way, there will be code issues that must be addressed in the plans for the project, and there will be easement and governance issues to be addressed, either in an REA or the condominium documents.

d. Pre-Sale and Post-Sale Alternatives

i. Although the establishment of easement rights and related governance issues will always be a part of a mixed-use project owned in parts by more than one property owner, the complexities of the development agreement and process may be simplified or even avoided if the split of ownership is deferred until after completion of the mixed-use infrastructure. This may be accomplished either by means of a ***pre-sale*** or a ***post-sale*** of the portion of the project to be divested by the primary developer.

ii. A pre-sale (that is, a sale in which the contract is signed before the development begins, but with a sale upon completion of shell construction) will not eliminate all of the complexities, but it should reduce them, if the pre-sale does not involve a commitment of funds by the buyer until after shell completion. (If the buyer is either purchasing the project before construction or financing the construction, then the issues described above for a multi-developer construction process will be largely the same.) In the case of such a pre-sale in which the buyer is not financing the improvements, the construction process is converted from at-risk obligations for the buyer to conditions precedent to the obligation to buy. While this mitigates considerably the downside risk of the buyer, it does not eliminate the buyer's compelling interest in upside protection, which requires a considerable say in the scope and timing, if not the budget, of the construction process. Adherence to plans, approval of change orders and delivery on schedule remain of paramount concern to the buyer. Cost risk is almost entirely shifted to the developer, except for change orders requested by the buyer. Due to the cost aspects and the impact on schedule and possibly the portion of the project retained by the developer, approval and management of change orders remains a zone of potential conflict in the pre-sale deal.

iii. The post-completion sale is the simplest way to deal with development risks for the buyer, but it is not at all the most attractive option. The distinguishing characteristic of such a sale from a pre-sale in which the buyer is not financing the construction is that the buyer is not identified during the development process and, therefore, has no say in it. Rather, the marketing of the project occurs after or just shortly before construction of the project is completed. Having eliminated the counterparty from the transaction certainly spares the developer the headaches of the political process. That relief comes with a hefty price, however. First, the developer must underwrite and finance the entire project cost. Second, the developer is designing and delivering a project that it does not intend to retain and may not be expert at developing, without any input from the ultimate owner, who at least in theory is an expert on the type of asset it is acquiring. Third, the developer does not have a bird in hand at the beginning, but instead is betting on there being at least two in the bush. Development hassle is replaced by considerable market risk.

IV. Governance and Management/Operational Issues with Mixed-Use Developments

a. Mixed-Use Governance

i. The threshold governance issue when a mixed-use project has more than one project owner is . . . "who's in charge?" That issue will be addressed in the REA or condominium declaration, as applicable (herein called for simplicity the "***Governing Documents***"). For the sponsor of the development, the answer is simple – the sponsoring developer is in charge, most likely as the "Declarant" under the Governing Documents. The sponsor can "steal a march" on the other owners by preparing the Governing Documents to establish the governance like the sponsor wants it – and then deal with the other owners when they surface and make changes to the extent required to secure the commitment to the mixed-use project from the other parties.

ii. In structuring the Governing Documents, the sponsor must decide how the project will be governed. Will it have an owners' association with a governing board, and if so, how will the board members be chosen (if the condominium structure is selected, an association and governing board likely is required), or will the Declarant act as a benevolent dictator? When the number of owners is limited, an owners' association is overkill, so a Declarant form of governance is typically used. Either way, the Governing Documents will provide the rules, rights, powers and obligations with respect to the common elements of the mixed-use project and, to an extent, the design and use of the separate mixed-use components.

iii. There are several key areas of concern that the Governing Documents will address, and often with great detail and significant complexity. These areas of concern include:

1) Ownership of the Common Areas – In an owners' association structure, the ownership of the common areas typically is placed with the association. If there is no association, the common areas may be defined as such but are owned as part of the parcels on which they are located. Either way, the Governing Documents will establish easement rights for all owners with respect to the common areas.

2) Management of the Common Areas – Again, in an owners' association structure, management would be in the hands of the association and its hired manager. Without an association, the Declarant would retain this power, subject to restraints imposed by other owners having the leverage to impose restraints.

3) Maintenance of the Common Areas – Typically, there are two options. The first is maintenance of the common areas is the responsibility of the association or the Declarant. This affords the Declarant control over the quality of the entire project. Alternatively, maintenance of a common area is the responsibility of the owner of the parcel on which the common area is located, who could be the association, if there is one. Lack of uniform control over things like parking lots presents significant issues when it is time to replace or do capital repairs.

4) Development Rights and Restrictions – The Declarant, recognizing that development is a dynamic process, will seek as much power as it can to modify components of the project to adapt to changing needs, including serving the best interests of the Declarant. This would include the right to enter the property of another owner to make alterations, install utilities or tie into amenities. The sanctity of property rights is at odds with such powers, so the non-Declarant owners will endeavor to restrict the exercise of such rights as much as possible.

5) Voting Rights – While the Declarant will endeavor to retain unlimited power during the development stage, until it exits the investment, ultimately, power will transfer to the owners as a whole, based on an allocation of voting rights. There is no set formula for voting right allocation, and when the project components are diverse, as is always the case in a mixed-use project, by definition, the allocation can be complex. Formulas based on square footage, acreage and valuation for tax purposes are options. One vote per project is not likely. The Governing Documents might assign the number of votes held by each parcel, with any subdivision distributing the voting rights allocated to the subdivided parcel to the owner among the subparcel owners. Sometimes classes of votes are used to allocate voting rights to different product types. The owners of residential condominium units would only have voting rights through the condominium owners' association.

6) Assessments – Costs of maintaining, operating, managing, replacing and enhancing the common areas are paid through annual assessments and special assessments on the property owners. Assessment powers are accompanied by lien rights, which may or may not have a priority senior to mortgage debt, but typically are subordinate thereto. Like voting rights, assessment responsibilities are allocated by formula. Ideally, the allocation of voting rights and of assessment obligations follows identical percentages, but some special assessment obligations are not pro rata as the need for the assessment is not of universal benefit to all owners or is the result of an owner's misdeeds. Allocating costs of an amenity or utility is straightforward if the amenity or utility is used exclusively by

one user or use category – that user should bear the whole cost of its use. However, multiple types of uses often share common areas and utilities. Consumption of such shared resources will vary in amount and intensity by use, so other formulae for equitable allocation of costs must be developed based on demand. When negotiating commercial leases, the practitioner should carefully evaluate the tenant's CAM obligations to be sure they are tied to actual use of common areas and utility consumption, if possible. Similarly, costs associated with use-specific amenities should not be subsidized by tenants engaged in other uses.

7) Use Restrictions – Prohibited use restrictions and known exclusive rights restrictions will be included in the Governing Documents so that they may be enforced against property owners and their tenants. The drafter should use caution when pulling an old REA off the shelf and re-using the restrictive use provisions, though. Restricted uses in an old shopping center or office building will likely have some applicability, but will need to be carefully tailored to avoid inadvertently banning a use that might be desirable in a mixed-use development.

b. Mixed-Use Management Challenges

i. Because each use in a mixed-use project is so different from the other uses, the management challenges likewise vary by the type of use, and the type of use that demands the most management attention is usually the use that is the most challenged from a market perspective. Ask any property manager of a mixed-use office-retail project and he will confirm that a widely disproportionate amount of management time and energy is devoted to the retail component. A small mixed-use development may get by with one manager who is responsible for the whole development. Larger mixed-use developments under common ownership may have an established hierarchy with a general manager responsible for administration of the entire development, and separate sub-managers with specialized skillsets for each use. If a hotel is a component of the property, a separate management team will always be required for those operations, as hotel management is highly specialized and regulated by the hotel's branding standards. The manager for each component of a mixed-use development must be adept at understanding the unique needs of each class of use in the project. The best mixed-use property managers have a background in all of the variable operations within the development, giving them a good grasp of the needs of each use and their interplay.

ii. Most of the uses in a mixed-use project are "passive" in an activity sense, in that there is very little interaction with the public at the core of the use. This would be true of office, residential and hotel (at the guest room level). Retail, however, must be very interactive if it is to be successful. The management demands of each type of use is largely driven by this nature of the use.

iii. The office landlord provides all services to its office tenants, unlike a retail landlord and retail tenants. For example, the most frequent complaints in an office building are "hot and cold calls," which are important but hardly threatening to the viability of the office tenant's business. In contrast, the retail tenant typically maintains its own HVAC system. This difference in scope of management services probably explains why office landlords pass through to tenants a management fee based on a "full service" rent, while retail landlords pass through an "administrative fee" based on common area maintenance charges.

iv. As indicated above, hotels are a completely different animal and must be respected as such. Of all the uses, hotels are the most management intensive, because of the service nature of the operation. No other use, for example, has to operate its own laundry. The hotel management agreement involves much more than just straight day-to-day management. It addresses the right to use the hotel brand, reserves for replacement of FF&E, and other unique features to running a business whose clientele and "rental rates" change daily. And the leverage of the hotel brands is very powerful and unbending. The best advice to a mixed-use developer who is contemplating a hotel as part of the project and who has no experience with hotels is, "let somebody else do that piece of the project."

v. The following focus on various management features of a mixed-use project are illustrative of the differences in service demand by each type, and the disproportionately negative impact that may occur on certain users when not adequately addressed:

1) HVAC – In a high-rise office or apartment building, HVAC is a service provided by the landlord. The landlord maintains the plant and distribution system and answers those "hot and cold calls." The typical retail tenant is responsible for its own HVAC unit, but the means of removing heat from the office to the atmosphere depends on the constraints of the project. The typical in-line retailer has its condenser unit on the roof, which it maintains, but in a high-rise project, that roof might be 20 stories above the store, so running a condenser water line to the roof is costly for the landlord. Therefore, at least a part of the essential HVAC system has to be provided by the landlord, using a condenser water loop or other means. This translates into a maintenance obligation and an operating charge of some kind to the tenant. The method of calculating that charge is as varied as the design of mixed-use projects. They take into account use demand, operating costs, depreciation of plant and equipment, and management services.

2) Electricity – As one of the top operating expenses of any real estate project, electricity demands careful planning and analysis. In the high-rise project, the base service is included in the rent charged to the tenant, whether office or residential. In an office setting, there typically is a baseline of service above which the office tenant is separately metered and charged. The retail tenant's space, which as an operating business typically has a high demand for electricity, is almost always separately metered, with as a direct customer of the utility or by submeter off of the landlord's master meter. In the latter instance, the matter of charge back to the tenant can become quite interesting. The landlord will typically tell the tenant that it will charge as if the tenant were a direct customer of the utility company, which sounds very fair, but really is not so much. By taking this approach, the landlord creates a small "profit center" in selling electrical service to the tenants, because the landlord is buying the service at "wholesale" and reselling it at "retail." Utility rate schedules typically are regressive in nature, charging way more for the first kwh than for bulk consumption down the line. This is so because the utility has to build the power plant to provide that first kwh, but once built, it wants to incentivize the customer to use as much of the plant's capacity as is available, so the rates drop with volume of consumption. By running the retail tenant through the rate schedule, the retail tenant is being charged at a higher average cost per kwh than the landlord is paying to the utility.

3) Trash – Again, the full-service office and residential tenant receives trash removal service from the landlord. In the case of the office tenant, the service is complete, because trash cans are emptied nightly by the night cleaning service provided by the landlord. In contrast, the retail tenant often must contract for its own trash removal. But there are deeper issues than that. The trash of a retail operation, especially a restaurant, is more management intensive than for an office tenant. For example, a restaurant has "wet" garbage that, if not handled properly, can smell and attract rats and vermin. In an office setting, this is intolerable, so the mixed-use project manager must plan for and then manage the storage and removal of "wet" garbage from the food services. This may require a separate "wet garbage" trash compactor and a refrigerated storage area within the restaurant space to store the garbage until taken to the compactor. In addition, the path of travel between the restaurant and the compactor must be considered, because that wet garbage will likely leak and give off odors during transit from the store to the loading area. Restaurants are outstanding amenities for an office or residential project, but they also present management headaches.

4) Security – While security is vitally important to all types of use, it is most intense with retail. In a high-rise building, access can be controlled, which greatly reduces the risk of a physical security event. Of course, a residential area should have heavily regulated access points to prevent non-residents from entry. However, retail must be open and inviting to the public, with valuable inventory on display. It is a haven for crime because it is so attractive. Therefore, management security in

a retail environment, and assuring that security risks do not affect the other uses in the mixed-use project, is of paramount importance. That landlords refuse to take any responsibility for security in leases should not come as a surprise, because with crime in a retail setting, the question is not "if" but "when."

5) Noise – Keeping noise isolated from certain users is important. Most mixed-use residents and office dwellers do understand that they are occupying an urban (or suburban) area and part of the consideration for moving into a mixed-use community is often the vibrancy of the development. However, they are not always on-board with the noise that can come with the lifestyle. It will be noisier than a stand-alone apartment complex or single family home in a strictly residential area, but proper design and drafting of restrictions can make it more palatable. Consider how the Governing Documents and commercial leases can limit the negative impact of noise from early-morning deliveries, trash removal and landscaping work, as well as evening sounds from a noisy restaurant or nightclub.

6) Odor – Like noise, and inherent to the consideration of trash management, residents and office dwellers will need protections from the impact of odors emanating from restaurant and certain other commercial uses.

7) Parking – One common goal of municipal officials in pushing for mixed-use development is reduction of automobile usage, but hotel guests, office dwellers, residents and their visitors still drive cars. Careful consideration to the mix of uses must be done to accommodate varying peak-time uses and avoid vast swaths of empty parking spaces. Residents will demand secure parking that is separate from the commercial uses, so gated areas with separate entry points will be necessary. In the retail world, the existence of plenty of free, easily-accessed parking is one of the first things a tenant will evaluate. Restaurants, hotels and some theatres and specialty retail may also want reserved valet spots. Office tenants will typically require reserved spaces, but they may be willing to walk some distance to get to them.

8) Leasing – We have saved the best for last. The assumption, particularly among urban planners, is that all uses will thrive equally in a particular location and that by mixing uses, the success of each is assured. Nothing could be farther from the truth. The great office location might be required to have "look but don't touch" retail on the ground floor. If the customer cannot easily access the retail, she will not patronize it. In this sense, "location, location, location" takes a back seat to "transportation, transportation, transportation." The management issue created by this disparity of demand characteristics is having to deal with the element or elements of the mixed-use project that are more likely to fail. If it is retail, the demand on management greatly intensifies. A struggling retail tenant, if not a national or regional retailer, will stop paying rent, will seek concessions, will see every adversity as being a landlord problem and not a tenant problem. The property manager is thrust into the role of counselor, negotiator and enforcer, often with a component of the project whose problems are way out of proportion to its relative size in the project. Whatever component of the mixed-use project whose demands are not easily met by the market in which it is located will suffer and possibly fail, creating challenges for the entire management team.