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THE CONTINUED GROWTH OF MIXED-USE DEVELOPMENTS

Mixed-use projects are a popular, efficient form of development, but not every parcel is zoned for every use.

By Paul Titcher

Changing demographics and the public's desire for convenience has sparked an explosion in mixed-use development. The acceptance and success of these developments, which combine commercial (retail, hotel, etc.) and residential components in the same structure (or common group of structures), has led to a revitalization of downtown areas and sparked a new trend of urban living. When this trend first started in the mid-2000s, a few visionary developers experimented with newly constructed and adaptive reuse projects despite an uncertain market. While the Great Recession stalled some progress, today we are seeing an explosion of mixed-use development on a scale that would have seemed unbelievable just a decade ago.

The numerous benefits offered to cities, developers and residents alike have contributed to the popularity of mixed-use developments. City planners have come to view mixed-use projects as a way to spur downtown revitalization by generating business activity in areas that slow or shut down after business hours. In addition, these projects are often located near mass transit, which helps to address the primary planning goals of encouraging the use of mass transit and decreasing dependency on automobiles. In recognition of these and other benefits, a growing number of cities eager to attract more mixed-use projects have enacted zoning provisions like density bonuses that encourage mixed-use projects. These incentives can have a measurable impact on a developer's bottom line.

Despite the benefits, developers should be advised that mixed-use projects are extremely complicated and require careful planning and attention to detail. Unique issues related to zoning, entitlement, design, financing, construction, insurance and organization of the project all must be successfully addressed to maximize the benefits of this specialized type of development.

The approval process, zoning and entitlements present challenges to a mixed-use developer that do not arise in a single-use context. Although some cities have created specific zones conducive to mixed-use development, few cities have enacted workable mixed-use overlay zones to simplify the entitlement process. Most property suitable for a mixed-use project is zoned either commercial or residential. The dilemma facing a mixed-use developer is straightforward — the residential zone may allow for development of the residential component of the project but not the commercial, and vice versa.

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NALS refinanced Sage Stone Apartments in Glendale, Arizona, in April 2017 with a $16.7 million Fannie Mae green loan. Qualifying for a green loan saved the company 15 basis points on the interest rate.

GREEN LOAN MARKET HEATS UP

Financing programs offered by GSEs reward apartment owners with lower interest rates for reducing water and energy usage.

By Taylor Williams

Mike Schell, a partner at NALS Apartment Homes, which owns and manages more than 15,000 units across the country, was looking to refinance Sage Stone Apartments in Glendale, Arizona.

Built in 2000, the property was on the cusp of eligibility for a green loan offered through Freddie Mac and Fannie Mae. The two government-sponsored enterprises (GSEs) grant lower interest rates on loans for multifamily properties whose owners have undertaken steps to reduce water and energy usage.

In April 2017, Schell obtained a 10-year, $16.7 million Fannie Mae loan for the refinancing of the property, which NALS purchased in 2009. NALS saved about 15 basis points on the fixed interest rate thanks to its sustainability efforts.

"Residents are increasingly interested in living in communities that are sensitive to sustainability concerns," says Schell. "In addition, the loan pricing and utility cost savings are very attractive to us."

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Design Planning

While mixed-use land use approvals are a key element in the process, that is just the beginning. Developers must carefully design mixed-use projects to prevent or mitigate future problems, especially those that can lead to litigation. These problems typically include noise, traffic, cost-sharing, and the placement and allocation of parking. This design planning is even more important if (as is often the case) the developer intends to sell various components of the project to different parties. These parties are inexorably linked in perpetuity, so the potential for future disputes is almost a certainty.

Fortunately, a number of these problems can be anticipated and addressed at the planning stage. For example, soundproofing between the commercial and residential components of the project is critical — residents do not want to be disturbed by noise from a business operation. Likewise, proper design of ventilation systems is important since residents will not tolerate fumes and smoke coming from adjacent businesses like restaurants. To maximize the benefits to the commercial tenants and minimize the impact on the residents, a developer needs to consider the location, use and design of access areas in the project. Considerations may include whether the retail and residential units will share elevators, parking areas and other common areas, as well as the location of retail loading areas and trash collection areas. Even small details are essential. For example, many retail and restaurant chains require satellite antennas to access entertainment sources, communications and inventory control systems. This may require conduits and easements across and through the residential components of the project to the roof.

Parking requirements and location must also be carefully examined. A developer will need to calculate the number of spaces required to adequately serve both components of the project. In working out the parking supply and demand, a developer could separate the commercial and residential parking structures, or implement a single shared parking structure. If parking is to be shared, however, additional issues must be identified, coordinated and resolved at the outset. These range from separate and designated parking areas and entrances for commercial and residential users, to misuse of designated spaces, (e.g., retail customers using residential spaces), security, valet program coordination, guest parking, etc.

Organizational Issues

When residential and commercial users share the same structure, a number of significant organizational issues arise. First of all, a property owners' association will likely be formed to coordinate the maintenance of the project structure and common areas. In a standard residential condominium project, homeowners association issues, such as cost sharing and control, are straightforward and familiar. However, new issues arise when voting power is allocated among both commercial and residential owners. The key to the allocation of votes is to ensure that neither group unfairly impacts the other. For example, if the residential owners are given too much power, it may enable them to create overly restrictive rules with respect to the retail units. One common result is that the retail owners are prevented from leasing to certain types of tenants. To prevent such problems, the project team must carefully consider this issue from both sides to strike a balance between these competing interests.

A mixed-use developer must also consider and determine an appropriate allocation of expenses among the various users. Since a mixed-use project will have common areas serving both the residential owners and retail tenants in different degrees, it will be necessary to determine who is responsible to pay for the various expenses. Maintenance costs can be based on a number of variables, including square footage, number of parking spaces and internal usage studies. A developer may also have to allocate utility costs. If utilities are not separately metered, a formula — often similar to that utilized for maintenance costs — will need to be adopted.

Titcher

Finally, use restrictions are another critical issue to consider. Use restrictions place limits on the activities permitted in the commercial space, including the types of tenants (e.g., no nightclubs), types of activities (e.g., no live music) and hours of operation. Developers must work hard to strike a balance that protects project residents without impairing the developer's ability to lease any retail space.

The rewards will be maximized and the surprises will be minimized if the challenges and issues associated with a mixed-use project are identified and tackled early on by the project team. As long as the demand for convenience draws residents and consumers to cities invigorated by mixed-use projects, developers will increasingly turn to mixed-use developments, with all of their unique challenges.

Paul Titcher, Partner, Cox, Castle & Nicholson LLP in Los Angeles

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Real Savings

According to Peter Giles, vice president of production and sales at Freddie Mac's multifamily division, implementing the upgrades can generate anywhere from 22 to 31 percent energy savings.

A 2015 Freddie Mac study found that if property owners can cut their utility costs by 10 percent, they could lower their asking rents to levels that are affordable enough to attract an additional 10 percent of the market. Given that 78 percent of renters prefer to live in environmentally friendly properties, according to Freddie Mac's renter research survey, this slashing of utility costs represents a means of creating competition for units, which leads to more money in landlords' pockets.

Giles

Giles cites a 430-unit property in Texas that was built in 1990 and underwent the gamut of water-saving upgrades as the epitome of the savings borrowers can achieve from green loans. The improvements on this property, which is located in a state with a serious water shortage, have thus far reduced water usage at the property by about 5 million gallons per year, which has translated into roughly $105,000 in spared utility costs.

"It's a win-win," says Giles. "We have seen an overwhelmingly favorable response from both lenders and borrowers that find the process fast, simple and efficient. We expect our suite of products and requirements to evolve as the program's popularity increases."

Giles adds some color to the numbers, noting that 5 million gallons is enough to fill eight Olympic-sized swimming pools.

"Numbers like that make it easy to see why this program has taken off," says Giles. "The growth has exceeded our expectations, and we are optimistic that it will continue to grow for years to come." ■

Sage Stone Apartments in Glendale, Ariz.

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constantly absorbing new information, scrutinizing and proactively seeking ways to improve will be the first to fall. The formula of telling everybody how great you are with a commitment to customer service and competitive fees just won't cut it today.

Awareness to change is more than downloading the newest app and reading tech blogs. The shift toward innovation is a major driver in our marketplace as companies continue to compete for clients and talent. Being able to effectively respond to not only rapid change but those who are expecting new resources and solutions will be the single most important factor for our industry in the next decade. ■