As appeared in…

www.crej.com

COLORADO REAL ESTATE JOURNAL

THE COMMUNICATION CHANNEL OF THE COMMERCIAL REAL ESTATE COMMUNITY

OCTOBER 15, 2014 – NOVEMBER 4, 2014

Legal issues in mixed-use projects

Jay Philp
Otten Johnson Robinson Neff + Ragonetti PC, Denver

Kim O'Hagan
Otten Johnson Robinson Neff + Ragonetti PC, Denver

In the past few decades, interest in sustainable development and the desire to live, work and play in close proximity have resulted in an increased number of mixed-use developments. Successful mixed-use developments are vibrant neighborhood centers that also address sustainability concerns by increasing population density, conserving land resources and facilitating public transit use.

These benefits come at a cost, however. The unique character of mixed-use developments often makes them more challenging to develop and manage. This article identifies some of the legal issues that should be considered in order to avoid common pitfalls of mixed-use development.

■ **What is mixed use?** Mixed use describes developments that combine two or more distinct uses, such as residential, retail and office, within a single project. Although they vary in scope and scale, mixed-use developments generally take the form of a single vertical building, a group of buildings in a limited physical area, or a combination of the two.

■ **Ownership structure.** A mixed-use development may be owned either by a single entity or by multiple entities, each of which owns a component of the development. Determining which structure is appropriate often involves balancing the benefits of centralized control afforded by single-entity ownership against the degree to which single-entity ownership complicates development and sale of the project.

Divided ownership may be preferable in developments relying on use-specific financing that carries restrictions, such as affordable-housing funds. Unless ownership is segregated, the affordable-housing funds' restrictions could burden other uses. Similarly, segregated ownership may facilitate a developer's exit strategies by enabling sales of specific uses, such as retail components of a development to a real estate investment trust or other buyer with limitations on ownership of nonretail properties.

Segregating ownership may afford some flexibility, but it also may add a layer of complexity – subdivision using a condominium or other structure may cause a state's common interest community regulations to apply to the development.

■ **Operational challenges.** One or more governing documents are often necessary to coordinate operation of a mixed-use development. The governing documents may vary depending on the particular development, but they usually will establish easements, identify restrictions on use and explain how costs are to be allocated.

Creating a fair allocation of maintenance costs and other expenses incurred by a mixed-use development can be difficult. Allocating costs of an amenity or utility is straightforward if the amenity or utility is used exclusively by one use or use category – that user should bear the entire cost. More often, however, multiple use categories share common areas and utilities. Because use of these shared resources varies in amount and intensity by use category, the simplest allocation method (proportional based on square footage) would likely be inequitable. Instead, the development's governing documents should specify an allocation of expenses based on the relative demands that different uses impose on the amenity or utility.

The governing documents should address maintenance of shared facilities by specifying who must maintain the facilities and how the maintenance is to be carried out. The documents should provide easements to allow access to the facilities for maintenance purposes. Likewise, they may protect properties burdened by maintenance easements by imposing notice requirements and guidelines for when the work is to be performed.

■ **Leasing issues.** Commercial leases in mixed-use developments may take longer to negotiate and be more complex than similar leases in single-use developments. Much of the negotiation will center on provisions allocating common area maintenance expenses and provisions governing exclusive use rights.

CAM obligations should be tied to actual use of common areas if possible. Similarly, costs associated with use-specific amenities should not be subsidized by tenants engaged in other uses.

Exclusive-use rights must be carefully reviewed to ensure that they afford the flexibility needed to attract tenants. In large mixed-use developments, where multiple retailers may sell any given product, narrower exclusive use provisions may be helpful. Provisions can define an exclusive use more narrowly, such as by specifying a particular type of restaurant, or by limiting the exclusive use to a specific geographic area within the development.

■ **Parking considerations.** The variety of uses in a mixed-use development complicates decisions regarding the amount and location of parking. Parking must be located so as to provide convenient access to retail and commercial components without creating too much noise or disruption for residents.

The amount of parking in a development is often a function of the ratio requirements in a zoning code. In a mixed-use development, however, simply adding up the parking requirements of different uses may create an unnecessarily high parking requirement for the development because parking spaces may be shared by different uses that create parking demand at different times. For example, retail components that require parking during the day may share parking spaces with residential components that need parking at night. Under these circumstances, relief from zoning requirements may be available to reduce the total number of parking spaces needed by the development.

Expectations regarding availability of parking must be protected. For example, retail tenants expect (and often require) free parking for their customers, while users of office space may be required to pay for parking. To protect retail spaces against "poaching" by office users, access to retail-specific parking facilities may be regulated.

Careful attention to the legal aspects of mixed-use developments allows developers, tenants, customers and neighbors to benefit from mixed uses while avoiding problems that could otherwise stifle the developments.▲