



## Special Considerations For Phased and Mixed-Use Development

By Steven P. Heller, Esq.  
and Sheldon A. Halpern, Esq.

**D**eveloping commercial real estate projects is inevitably challenging. Phased and mixed use developments create additional levels of difficulty for both developers and attorneys.

Developing a shopping center in phases over time has always been relatively common, and mixed-use development is enjoying a renaissance of sorts, but standard form documents rarely deal comprehensively with the special issues that demand consideration, including those relating to the parties' construction and payment obligations.

### Phased Development

Phasing usually occurs when at least one of the pieces to the puzzle of creating a successful development is missing. For example: (1) The developer has a deal with an anchor, but no other retailers, and is under contract with a land owner to purchase the land for the proposed development. The anchor deal provides only sufficient funds for the developer to purchase the land, but the developer is optimistic that the future for this location is bright and is willing to perform limited site work on a speculative basis, but will not perform additional site work until it has sold additional parcels. (2) The seller is required to remediate contamination on a portion of the land, and the developer is not willing to purchase the balance until the remediation is complete. (3) The land required for the entire development is not owned by one party, and deals with all owners have not yet been made. (4) The governmental entitlements require that expensive off-site work (e.g. construction

of a freeway interchange) be performed if and when a specified number of automobile trips are generated by the development, and the developer is not anxious to trigger this requirement. (5) Only a portion of the property has been completely entitled.

### • *Impact on Construction Costs and Cost Sharing*

Site work construction costs are likely to be greater per square foot in a phased project. For example: (1) Inflation is likely to impact construction costs. (2) Efficiencies in grading attributable to balancing cut and fill areas might be unavailable. (3) Contractors are likely to be more competitive on a larger project. (4) The same general contractor may be unavailable for later phases of the development, and subcontractors must be reassembled (pursuant to a new bidding process) at one or more later dates. Nevertheless, the developer often prefers performing only the site work required for each successive phase when that phase is being constructed (plus any additional site work it elects to perform because costs would substantially increase if performance were delayed to a later phase).

In one "typical" phased transaction, the cost of the developer's on-site work is often fixed, or included in the purchase price, in a conveyance to an anchor. The off-site work costs might also be fixed; however, since they are harder to estimate (especially if the governmental requirements are not finally determined), such costs are more likely to be allocated in accordance with a percentage sharing formula, perhaps subject to a "cap."

The anchor is likely to have approval rights as to the plans, the contractors and the bidding process for all site work, at least in the current phase. Issues frequently arise as to exclusion of certain costs from the costs to be shared, the time and manner of payment for future site work, and the manner by which the sharing percentage is calculated.

Two primary percentage calculation issues typically arise: (1) is the percentage based on land area or floor area, and (2) to what extent are future phases included in the denominator of the fraction utilized to generate the cost sharing percentage? The land area/floor area distinction only matters if the land area of some of the parcels is not proportionate to building size or if all of the projected floor area has not yet been constructed. Assuming the distinction is relevant, the developer should determine whether it is worth the complexity to provide that certain site work costs more closely associated with land area (e.g., storm sewer facilities or grading) are allocated by land area and that other site work costs more closely associated with usage (e.g., traffic

*Continued*



**Steven P. Heller** is a partner at Gilchrist & Rutter in Santa Monica, Calif. His practice focuses on commercial real estate and business transactions. Contact him at [sheller@gilchrutrutter.com](mailto:sheller@gilchrutrutter.com).

## Special Considerations *continued*

signals and other street improvements) are allocated by floor area. The problem for the developer in including future phases in the denominator of a land area calculation is that the developer will then be responsible for bearing the share for future phases prior to their development and sale. On the other hand, the early phase parcel owner does not want to pay for site work to the extent it benefits other property. Performance of site work benefiting a phase only when the phase is developed solves this problem.

### Mixed-Use Projects

The mixed-use concept is not new, but a contemporary assortment of constraints and market trends is driving the current increase in mixed-use projects, such as the decrease in available land for development and the concurrent increased interest in live/work urban spaces. Developers of mixed-use projects need to consider alternative and creative approaches to legal documentation to address the unique development issues, especially use, construction and expense sharing issues.

- *Legal and Governance Approaches*

The uses in a mixed-use project may change with a frequency that might make static zoning designations impractical. Accordingly, mixed-use developers seek flexible, special-district zoning so that the developer does not need to continually seek variances to accommodate changes among differing types of potential buyers and tenants.

Developers and government agencies sometimes work out symbiotic relationships to fit the unique characteristics of a mixed-use project into standard governmental requirements. For example, peak usage times for movie theaters and office buildings occur at different hours and days, so a government agency addressing a project with these uses may be willing to reduce a developer's overall parking requirements. Convincing anchor retailers, who are accustomed to traditional parking ratio

requirements, may be a challenge for the developer and its attorney.

The internal governance of a mixed-use project also poses challenges that might not arise when crafting legal documentation for a single-use project. When a developer's attorney prepares governing documents for a mixed-use project (such as a reciprocal easement agreement), the attorney needs to determine the most efficient and flexible way to govern diverse uses, including allocation of decision making (for example, use approvals) among different types of owners and users. Developers should consider using different documents to govern different user categories, whether grouped by use, location or otherwise. Some complex projects may require two, three or more sets of governing documents, and their relative priority must be carefully established.

- *Vertical Construction*

Building costs among different types of mixed-use projects can vary widely, especially when the project is vertical. For example, the cost of constructing the underground parking required for a vertical development is substantially more than the cost of constructing surface parking. The cost of constructing residential units above a supermarket may be impacted by the need to design and construct appropriately sized units that are structurally and architecturally consistent with the preservation of the market's standard dimensions. Because both supermarket customers pushing shopping carts and residential occupants might not be used to parking underground, operational challenges may arise as well.

- *Expenses & Taxes*

In a single-use project, occupants typically share costs under a relatively simple formula pursuant to which each user pays its pro rata share. But in mixed-use projects, different types of uses result in a range of types and amounts of costs for various items. Some users may use certain services or utilities exclusively (or at disproportionate levels).

For example, residential users do not use the same volume of utilities that a restaurant uses but may exclusively use a separate elevator or lobby area that is located within a retail facility. Equally shared payment obligations may result in inappropriate allocations.

It is often useful to arrange, if possible, for separate tax assessment of discrete portions of a mixed-use project, so that each user is responsible only for its own taxes. Absent separate assessment, an increase in property taxes for one set of users can impact others. For example, a reassessment resulting from the sale of the office portion of a mixed-use project could impact the tax obligations of the retail anchors, who may press the developer to indemnify them. Certain users may also seek protection from assessments attributable to special assessment districts formed to construct required infrastructure.

### Conclusion

No developer would capriciously choose to take on the burden of solving the various construction, governance, cost and use problems raised by phased and mixed-use projects. But these entanglements naturally result from the exigencies and advantages of phasing projects and from the benefits of mixed-use projects that are increasingly attracting residents, office tenants and retailers. Parties that fail to put phasing and mixed-use issues on the table, or that fail to provide for their resolution in the documents, risk substantial operational and cost surprises.

*Steven P. Heller is a partner at Gilchrist & Rutter in Santa Monica, California.*

*Sheldon A. Halpern, Esq. is a partner at Pircher, Nichols & Meeks in Los Angeles, California.*

*© This article was originally published in Shopping Center Business, June 2005. France Publications, Inc., Atlanta, GA (404) 832-8262 [www.francepublications.com](http://www.francepublications.com)*