IN THE SPOTLIGHT: PLANNING FOR REDEVELOPMENT

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For years, the commercial real estate market has been sizzling. Cap rates are down. Prices are up.

Nevertheless, you managed to beat out the competition and buy a few shopping centers. To justify the price you paid, however, you need to increase the net operating income (NOI) from your property. Now, however, the economy may be facing the headwind of a slowdown, if not an outright recession, which creates resistance to rent increases; so you may not be able to rely on ordinary rent increases to bolster your NOI.

Instead, you may need to redevelop your property by tearing down or renovating inefficient or less attractive buildings and constructing new buildings that will generate greater overall revenues from your property.

An effective redevelopment plan requires:

- Review and analysis of the current leases and other documents encumbering your property
- Determination of the redevelopment potential for your property under applicable zoning and construction code requirements
- Identification of your redevelopment goals
- Negotiation of leases and other agreements that will permit the desired redevelopment.

Likely Limits

First, you must determine whether the current leases, easements, and other agreements affecting your property restrict redevelopment and they almost always will. Anchor tenants typically restrict changes to the parking field serving their premises, as well as major entrances to the property. Each tenant may have rights to the common areas that limit construction of new buildings. Easements granted to utility companies may further limit your renovation potential, and your loan agreements may also restrict new construction, especially if you have borrowed from a conduit lender.

Accordingly, the first step in any redevelopment plan is a thorough review and abstracting of all of the agreements affecting your property. Unless your property is unoccupied or most of your tenants are on month-to-month leases, the most important documents to review are your tenant's leases. Each of these leases should be reviewed for a variety of provisions.

Tenant Rights

For example, you will need to determine whether any tenants rights restrict your ability to modify any portion of the common areas of the property. You will also want to summarize the current term and any option terms for each tenant. It may very well be that you want to tear down the building in which a particular tenant is located, and the duration of this tenant's lease will either delay your plans or give the tenant leverage against you in negotiations to relocate the tenant or terminate this tenants lease. In addition to other important provisions, determine whether the lease provisions require each tenant to cooperate with renovations to or replacements of their storefronts and signage; whether you may enter each premise to relocate conduits or otherwise facilitate the renovation; whether the tenant must contribute to certain costs of the renovations; and whether the tenant has other rights that restrict redevelopment.

The results of each of these lease reviews should be summarized in a written abstract so that you are not continuously re-reviewing leases to determine applicable lease provisions. Each abstract should also be dated so that, for example, you know whether the abstract includes the latest lease amendment which is especially important when your redevelopment project spans many years.

Analyze and Plan Ahead

Similar analyses should be conducted regarding all of the other encumbrances affecting your property. Your plans may require relocation of utilities and all of the attendant negotiation with the applicable utility company. Similarly, your loan agreements may restrict redevelopment. Your lender may require increased reserves, insurance, and additional collateral, and limit activities that could jeopardize your property's cash flow. Further, some lenders especially conduit lenders present almost insurmountable bureaucratic hurdles to any property changes that have not already been incorporated into the loan documents. One client endured almost two years of delay procuring the approval of a conduit lender for a simple parking lot expansion. So, at the very least, advance planning is required for any efficient redevelopment plan.

Second, and equally critical, determine your property's maximum development potential and the restrictions applicable to your property under the zoning and construction codes. In some instances, you will be planning for a redevelopment opportunity that will hinge on a rezoning of your property years in the future. In other instances, you may be able to obtain special exceptions or variances that facilitate your redevelopment, or you may be simply adding buildings that you may construct as a matter of right under current law.

Be Aware of Accessibility Requirements

Recognize, however, that while the potential for expansion may exist under applicable zoning requirements, considerable burdens may be imposed by construction code and other requirements. As the years have passed, life-safety and building code requirements have increased considerably. Also, in the 1990s, both the Americans with Disabilities Act and the Federal Housing Act accessibility requirements were imposed on commercial and multi-family projects. Indeed, with the prevalence of mixed-use projects that combine retail, office, and residential uses, the analysis of applicable accessibility and other legal requirements have grown increasingly complex.

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Furthermore, any redevelopment may not only require significant new improvements for new buildings but also may trigger mandatory retrofitting of existing structures. For your redevelopment to progress in a timely fashion and within budget, you must have a thorough understanding of the many applicable legal requirements and governmental processes involved in reaching a successful completion.

Evaluate Tenant Mix

Third, once you have any understanding of the restrictions imposed by both property encumbrances and legal requirements, you can plan your desired renovation. This planning should take into account both your existing tenant mix (unless you are terminating all of your current leases) and the market for potential tenants. In considering your existing tenant mix, evaluate which tenants will complement the current tenants. However, in other instances, you may be planning a drastic redevelopment in which you may wish to retain only a few, if any, of the existing tenants and create a new vision and tenant mix for the property. Here, you must carefully assess the strengths and weaknesses of your property, market conditions, and the demand for space from new tenants.

In one project, a mall, which had become rundown and filled with unattractive tenants, was redeveloped. While competing properties were newer and bigger, and boasted a far better tenant mix, the property had a unique strength: It was located in one of the highest income areas in the country, convenient to thousands of wealthy households and parents who doted on their young children. The developer established a vision for this small mall as a boutiquey-Mommy & Me property and set about attracting the proper tenants.

Early Sacrifices Pay Off

First, the developer attracted two national anchor tenants that would draw families in. The developer sacrificed rent and provided considerable concessions to procure these anchors. Then the developer courted a few prominent local retailers with strong local followings, one a shoe store for children that was famous locally with parents, and the other a boutique that sold high-end gifts for newborns and young children a tenancy that added a considerable touch of class. At this point, it became easy to sign up a nationally recognized after-school learning center for children a gymnastic facility geared to parent and child activities, and a variety of boutiques that sold upscale clothes to mothers and kids. Within a couple of years, and with a lot of creativity and hard work, an undersized, dowdy mall with annual rents averaging in the teens was transformed into a vibrant mall with annual rents in the high twenties and low thirties and a waiting list for new tenants.

Evict Deadbeats

In another case, a strip center that had been poorly managed was bought and redeveloped. The existing tenants were in widely disparate businesses; some didn't even open for business on a regular basis, and the only thing they had in common was that they frequently failed to pay their rent. In this instance, the landlord established a new vision for the property as an upscale, convenience-oriented strip center. It evicted the tenants that did not fit into the new vision for the property. The landlord then performed a facelift on the property, with new exterior walls, prominent sign towers, new landscaping, and a resurfaced parking lot. At this point, the landlord began to increase rents dramatically because it was leasing good-looking premises that were part of a logical tenant mix.

Next, the landlord bought land adjacent to the existing shopping center. This additional land also bordered a heavily trafficked intersection. It built an attractive new building on this additional land, creating both a prominent physical presence for the property and desirable premises that were leased at more than double the rents derived from the original property only four years earlier. In less than half a decade, a dumpy, class C strip center was converted into a trophy property that has tripled in value.

Tighten Tenant Obligations

Whether you are planning to redevelop your property or merely want to preserve that option, you must negotiate into your leases a variety of rights and protections. Notably, you should expressly preserve the right to build new structures in the common areas. Likewise, you should obtain provisions enabling you to construct new storefronts, change signage, close parts of the property, and engage in a variety of other activities that will enable you to renovate your property. You should also try to obtain the right to relocate certain tenants, especially those that are in the likely path of construction. Better yet, try to obtain the right to terminate certain leases in the event you desire to demolish certain buildings. Such demo clauses are difficult to obtain. However, when a tenant is renewing its lease, it is much easier to justify including a demo clause in a new renewal option that the tenant requests and to which the tenant is not entitled. Likewise, the pain of relocation or termination can be softened if you provide the tenant with reimbursement for the cost of certain unamortized improvements. All of these lease provisions can prove essential to any successful redevelopment.

Growing Redevelopment Potential

This program for property redevelopment from document and legal review to identifying your vision for the property and negotiating the deals necessary to realize that vision can allow you to redevelop your property successfully. Given the competition for retail properties and resulting high prices, property redevelopment may become as necessary and common a process as ordinary maintenance and repair. Certainly, in appropriate instances where your property

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Jack Garson's practice focuses on Real Estate, Construction and Business law. He serves as a legal advisor for numerous local, regional and national companies. In his role as legal counsel, Jack also serves as a strategic advisor and lead negotiator. Further, Jack provides guidance on the structure of complex transactions, the resolution of business disputes, the growth and sale of companies, and the management of issues such as liability and risk reduction, employment practices, and enhancing profitability.

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In the past two years, we've grown by 50% through expansions in New York City and, most recently, Charlotte, North Carolina. This growth has provided immense value to our clients and attorneys.

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