MIXING IT UP: AVOIDING COSTLY MISTAKES IN MIXED-USE LEASES

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I. INTRODUCTION

For much of our country's history, mixed-use development has been associated with dense, landlocked older cities as a matter of necessity. However, changing market dynamics and personal preferences have now created demand for mixed-use developments in areas that historically have not had such development constraints. For example, in recent years the Texas real estate market has experienced a growing premium placed on developments that offer living, hotel, office and shopping uses in a neighborhood environment. This movement, known as "New Urbanism", advocates organized, sustainable growth through high density housing and mixed-use development in a pedestrian friendly environment. New Urbanism appeals not only to the public who enjoy the convenience of working, dining, shopping and living in close proximity, but also to real estate developers who have seen that structuring mixed-use projects allows them to maximize the use and value of the development as a whole. In order to ensure that a mixed-use project is attractive to purchasers and tenants, financeable by lenders and feasible as a profitable business model, the developer must carefully structure the development from a practical and legal standpoint.

Since mixed-use projects often involve dense developments that integrate a variety of uses separated both horizontally and vertically, real estate professionals have been forced to re-examine their leases to address issues which are unique to these types of developments. This paper will analyze those provisions in commercial leases that are most likely to be affected by the location of the premises in a mixed-use project. A particular emphasis will be placed on the impact that a condominium form of governance has on leases. However, prior to addressing the leasing issues which arise in modern mixed-use developments, it is first important to understand the history of mixed-use development in America, as well as the various types of mixed-use projects one may encounter.

II. THE HISTORY OF MIXED-USE DEVELOPMENT

A. The Decline of Traditional Mixed-Use Development. Mixing uses in a single development was a common practice in this country since the early 20th Century. In the early 1900s, these developments were often located within walking distance of a transit stop and the core commercial area. Mixing residential, retail, office, open space and public uses in a walkable environment made it convenient for people to travel by trolley car, bicycle, foot or, in rare circumstances, automobile.

However, two factors contributed to the decline of mixed-use developments beginning in the early 1900s. First, the mass production of the automobile created more mobility among people, thereby reducing the public's dependence on dense developments where people could live within walking distance of their shopping, working, schooling, worship and recreational activities. The second factor leading to the decline of mixed-use developments was the development of modern zoning and land use practices. As America developed into an industrialized nation, people began to realize that the pollution produced by many of the buildings in which people worked was detrimental to those who live nearby. As a result, local

governments adopted Euclidian zoning policies, which separated land uses according to function.[1] The primary intent of these zoning laws was to segregate residential communities from industrial uses which were hazardous to the health of the community. While this initially still allowed for some mixed-use development (such as mixing residential buildings with retail space), throughout the first half of the 20th Century, municipal zoning codes increasingly segregated land uses such that by the 1950s, mixed-use development was essentially non-existent. Houses were segregated from virtually every other type of use, creating the suburban bedroom communities that are still prevalent today.

B. The Resurgence of Mixed-Use Development. The trend toward Euclidian zoning began to change in the 1960s and 70s as municipalities began to deal with the decay of their inner cities. City planners understood that mixed-use development would be a critical component in their efforts to revitalize the urban areas of many large cities. This realization coincided with the publication in 1961 of the book *The Death and Life of Great American Cities* by Jane Jacobs, perhaps the most influential book written on urban planning during the modern age. The book squarely placed the blame for the decay of inner-cities on the Euclidian zoning policies requiring a separation of uses. Communities, she argued, thrive when they develop a dense and mixed-use urban environment that preserves the uniqueness inherent in individual neighborhoods. As a result, some city planners were persuaded to reconsider mixed-use development as a means of saving their inner-cities.

C. The ULI Perspective – Planned Unit Developments. In 1976 the Urban Land Institute published a technical bulletin entitled, *Mixed-use Development: New Ways of Land Use,* which defined a "mixed-use development" as a relatively large scale real estate project characterized by "(i) three or more significant revenue producing uses..., (ii) significant functional and physical integration of project components... and (iii) development in conformance with a coherent plan."[2] This definition was no doubt colored by the redevelopment taking place in some of the inner-cities, but also by the proliferation of planned unit developments ("PUDS") in the 1960s and 70s, which allowed developers to essentially create their own zoning for large scale mixed-use developments, thereby allowing a mix of uses not otherwise permitted by the zoning codes. The development of a PUD required large tracts of available land and cooperative government. A good example of a PUD in Texas created during this period is The Woodlands, north of Houston. Although large-scale PUDS comprise an important part of the history and definition of mixed-use development, because of the scarcity of large tracts of land near most desirable urban centers, they are likely not the future of mixed-use development.

Today, mixed-use as a development type seems to have come full circle. Mixed-use development now is conceptually more akin to the mixed-use commercial corner common in the early 20th Century. While the 1970's concept of mixed-use development was oriented toward

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[1] Euclidian zoning traces its roots to *Village of Euclid v. Amber Realty Company*, 272 U.S. 365, 47 S.Ct. 114, 71 L.Ed.303 91926), where the United States Supreme court upheld a zoning code which divided the Village of Euclid, Ohio, into six separate use zones, three classes of height zones and four different density zones.

[2] Witherspoon, Robert, Jon P. Abbett, and Robert M. Gladstone. 1976, *Mixed-Use Developments; New Ways of Land Use*. Washington D.C.: ULI.

creating activities and event centers, today's concept of mixed-use is oriented more towards integrating commercial and housing activity on a smaller scale that is pedestrian friendly and often linked to transit. The Mockingbird Station project in Dallas is a perfect example of this.

D. The Current Mixed-Use Madness. So why has the pendulum swung back toward the types of mixed-use developments which were common over 100 years ago? History often repeats itself. There appears to be a growing realization among city planners and developers that Jane Jacobs was correct. Creating sustainable neighborhoods necessarily involves mixing uses to create an environment that is unique and vibrant. In addition, as the U.S. economy has evolved into a more service oriented economy from an industrial one, the environmental hazards associated with living in a mixed-use development have largely disappeared.

While the redevelopment of obsolete inner city buildings and blighted areas is nothing new to the older cities of the Northeast and Midwest, in today's high growth Sun Belt cities, second generation development is just beginning. Cities such as Dallas, Houston and Phoenix are a couple of hundred years younger than some of their eastern counterparts and are just beginning to mature as urban environments. As the outward expansion has extended beyond reasonable commuting distance, redevelopment of urban areas is becoming a viable if not necessary concept. Therefore, much as was the case with the Rust Belt cities during the 60s and 70s, the need to revitalize these cities has caused developers and municipalities to turn to mixed-use.

Why do mixed-use developments revitalize cities? First, a proper mix of use populates and activates neighborhoods not only during the day, but also in the evening. This creates a vibrant community where people are encouraged to gather and congregate with their neighbors. In addition, mixed-use developments reduce the need to use a car for every trip, thereby reducing traffic congestion and pollution. These and other factors make the community more healthy, safe and desirable. In short, this type of development allows for neighborhoods to become sustainable over time.

However, mixed-use is not only for urban environments. The recent population shift to the South and West has changed the demographics of the Sun Belt cities. Many of the migrants are coming from the Northeast and Midwest, where they are not as dependent on the automobile for transportation and enjoy the denser, urban life style. As a result of this migration, developers have discovered that mixed-use can even work in suburban areas, as evidenced by the success of developments such as Southlake Town Center in Southlake and Legacy Town Center in Plano. Modern trends and personal preferences have caused many people to yearn for the days where they do not have to get in their automobile to go to a restaurant, catch a movie or get a haircut. As a result, many suburbs have jumped on the mixed-use band wagon and have encouraged this type of development.

III. FACTORS AFFECTING MIXED-USE DEVELOPMENT LEASES

This trend back to mixed-use development creates many issues which must be addressed in leases in order to create a successful mixed-use development. However, before these issues

are addressed, it is first important to understand that all mixed-use developments are different and therefore create different issues in the legal documentation.

A. General. As previously discussed, the term "mixed-use development" is a broad term that can include anything from a three story apartment building with ground floor retail to a major planned development. The leasing issues that arise will vary depending upon the physical nature of the development, the governance structure, and the ownership structure, among other factors. For example, if the mixed-use project is vertically subdivided (i.e., where multiple uses are segregated by floor in the same building), the parties will have access and cost sharing issues that are different from those arising in connection with a typical horizontal subdivision. Similarly, if the integrated uses of a mixed-use development are under multiple ownership, many issues arise with respect to access, cost-sharing and the like, which may not be issues if the entire project is owned by one landlord.

B. The Governance Structure of the Development. The appropriate governance structure for a mixed-use project is typically a function of the layout of the project, the nature of ownership and use of the various components of the project and the legal structures that are available under applicable law.

1. The Condominium Craze. Historically, many mixed-use projects were accomplished through a horizontal or vertical subdivision, involving complicated conveyances of air-space rights, overlaid with various reciprocal easements, covenants and restrictions. However, many developers have recently opted for a condominium structure for their mixed-use projects.

There are several advantages to creating a condominium structure. Perhaps the most compelling reason for structuring a mixed-use project as a condominium is that the development of a condominium usually does not require the property to be replatted.[3] If the developer were to sell different uses within the project as separately platted lots, each lot would be subject to the municipality's platting requirements, including set backs and other limitations. The developer should be aware, however, that subjecting the property to a condominium does not exempt the property from zoning requirements as condominiums are subject to applicable zoning.[4] The developer should ensure that the condominium is located in an area that permits multiple uses. In addition, since most states have enacted some form of condominium statute by now, the law in this area is fairly well established and this allows the parties affected by the condominium regime to be fairly certain as to how they will be treated over time. Finally, both lenders and title insurance companies have grown more comfortable with this form of ownership and that has eliminated any impediments to financing and insuring title on a condominium project.

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[3] *But see* Opinion of the Attorney General of Texas, No. GA-0223, July 30, 2004. The Attorney General correctly pointed out that while Section 82.006 prevents a county or municipality from discriminating against the condominium structure, the county or municipality nonetheless has the right to regulate condominiums in a manner consistent with other forms of ownership structures. Despite the limited scope of the opinion, an extension of this analysis would likely give any municipality or county a strong argument that a condominium is subject to the same platting requirements as any other development within the vicinity.

[4] TEX. PROP. CODE § 82.006.

On the other hand, the condominium structure can be costly to establish and maintain, and it also subjects the developer to certain state and federal laws that might not otherwise apply, requiring extensive documentation and an in-depth understanding of specific condominium concepts that are discussed in Section IV below.

2. Subdivisions within Subdivisions. The condominium structure has the further advantage of allowing the developer to either create vertical subdivisions within a larger horizontal development or legally separated portions of the development by use, regardless of where they are physically located. This is done by forming sub-condominium regimes within a larger master condominium structure. This allows the developer to create condominium units based on the separate uses, and then to further condominiumize the space within each of those units. For example, a developer in a mixed-use condominium may create a master condominium structure including five units: a retail unit, an office unit, a hotel unit, a residential unit and a parking unit. Within any of those units, the developer may create a sub-condominium allowing such unit to be further subdivided. The typical example would be the residential unit, which would be further subdivided and sold off as individual residential condominium units. The Victory Park development surrounding the American Airlines Center in Dallas is a good example of a project that uses this structure.

3. Relationship to Landlord Lease Obligations. The condominium structure is also favorable because it allows the developer to globally address many of the issues discussed later in this paper. Traditional landlord obligations (such as insurance, casualty restoration, repairs and maintenance, establishment of rules and regulations, etc.) become matters for the condominium association and are addressed in the condominium declaration. While the association may handle these matters on a project wide basis, the landlord for each unit would pass through the condominium association assessments to the various tenants. This is also advantageous to the landlord/developer, because it often eliminates the ability of the tenant to have a say in these matters. However, this puts a burden on the landlord/developer to fairly allocate expenses and protect the tenants or it will have a difficult time attracting quality tenants to the development.

C. The Ownership Structure of the Development. Another issue developers encounter in connection with mixed-use developments is whether to segregate the ownership of the various uses or keep ownership of the entire project in one entity. Many lenders and equity investors have historically preferred to participate in one particular product type in a mixed-use project either because they are not comfortable underwriting the variety of uses and the risk associated therewith or perhaps they have internal restrictions against investing in a particular product type. Whatever the reason, in many cases different lenders (and sometimes different equity partners) are utilized in connection with the different uses developed within the same project. As a result, many owners have opted to segregate the ownership of various uses. Separating the ownership of the uses and individually financing them also provides the owner with additional exit strategy options, because it allows the owner to sell one portion of the project (and satisfy that loan) while retaining ownership (and the financing) of another. Of course, this benefit could also be derived through the use of the condominium structure, so long as the loan on the project allowed for a partial release of the unit being sold.

IV. BASICS OF CONDOMINIUM LAW[5]

The purpose of this section is to provide the reader with a basic understanding of the structure and operation of a mixed-use condominium in order to better anticipate and address the tension among the condominium documents governing a mixed-use condominium (the "Condominium Documents"), the Texas Uniform Condominium Act (the "Act")[6] and a lease for commercial space in a mixed-use condominium. This section will also address the interaction between the tenant, the landlord, the condominium association and the owners of units within a mixed-use condominium that arises but virtue of the Act and provides sample provisions for use in a lease or in the Condominium Documents that may enable the parties to attain better negotiating positions and to make more informed decisions when negotiating leases.

In order to understand how a condominium structure may affect your lease, it is first necessary to understand the basics of condominium law. The Act governs condominium formation and governance in Texas and is modeled after the Uniform Condominium Act, which has been adopted by over 20 states. Unless the Act states otherwise, its requirements cannot be modified.

A. Condominium Concepts. The following terms are commonly used throughout Condominium Documents and are considered the basic building blocks of a condominium:

1. "Units." Generally, Units are boxes of air that can be conveyed in fee. Units can vary in size and purpose and some common examples of Units found in a mixed-use condominium include retail units, parking units, office units, storage units, hotel units, and residential units. Even though residential units are frequently sub-divided into traditional "condos", the Act provides an owner of a Unit the right to sub-divide it into separate fee estates regardless of its use. Subdivision is accomplished by filing another set of Condominium Documents, so in the case of a two level condominium, there would be both a master set and sub-unit set of Condominium Documents. If the demised premises is located in a sub-unit of a master condominium, that space will be subject to and governed by both sets of Condominium Documents.

2. "General Common Elements." In a condominium, there are two types of "common areas." General Common Elements are portions of the condominium that can be used by all of the Unit owners. Some obvious examples of typical General Common Elements include the land underneath the condominium, sidewalks that surround the building, main lobby areas and courtyard areas. The structure of the building and systems that serve all of the Units are also General Common Elements.

3. "Limited Common Elements." The second type of "common areas" is Limited Common Elements. Limited Common Elements are portions of the condominium that can be used by one or more, but not all, of the Unit owners; the use of Limited Common Elements is more exclusive than the use of General Common Elements. Examples of typical

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[5] The author wishes to acknowledge the contributions of Lorin Williams Combs and Jeanne Marie Caruselle Katz of the Winstead Planned Community, Mixed-Use and Condominium Group for their contributions to Articles IV and V of this paper.

[6] TEX. PROP. CODE § 82.001 *et seq.* (West 2012).

Limited Common Elements include parking spaces, hallways, balcony areas, recreational facilities, elevators and stairs. General Common Elements and Limited Common Elements are collectively referred to as the "Common Elements."

4. "Allocated Interests." Each Unit has an undivided ownership interest in the Common Elements (the Common Elements are not owned by the Association or any other third party). The amount of each Unit's interest in the Common Elements is based on the Allocated Interest assigned to that Unit. The Allocated Interests must be defined in the Declaration and based on a stated formula. The Act does not mandate what formula is used, but it does require that the method used cannot "discriminate in favor of Units owned by the Declarant." The most common formula used in the calculation of Allocated Interests is a percentage based on the relative square footage of each Unit to the total square footage of all of the Units in the condominium. However, the formula for calculating the Allocated Interests could also be based on anticipated use by each owner, third-party reports of actual usage after a reasonable period of usage, utilizing the appraised value of each Unit, or a formula that includes subsidization of one or more uses based on benefit received or on the burden inflicted. Without an agreement to the contrary, Allocated Interests are also used to distribute liability for the Common Expense costs among the owners.

5. "Declarant." The Declarant is normally the developer of the condominium, who may or may not be the landlord, depending on whether it has sold any Units to third parties. Generally, a Declarant will reserve extensive rights to develop the condominium, including the right to add real property to the condominium and to access all portions of the condominium, including the Units. Additionally, in a master condominium, the Declarant normally maintains control of the Association.

6. "Association." The day to day operations of the condominium are handled by the Association, which is normally a Texas nonprofit corporation. The Condominium Documents grant the board of directors of the Association with the power to make many important decisions, including the ability to set the annual budget, grant variances to the Regulations, and approve the plans and specifications for alterations to the Common Elements and certain alterations to the Units. Each owner is a member of the Association.

7. "Common Expenses." Owners in condominiums are responsible for their assessed portion of the Common Expenses. Common Expenses are the Association's expenses incurred in maintaining the Common Elements and fulfilling the Association's duties under the Act and Condominium Documents. Examples of Common Expenses include the cost of utilities that serve the Common Elements, landscaping costs, and insurance costs. As previously mentioned, under the Act owners are obligated to pay assessments for their portion of Common Expenses based on their Allocated Interest, however, in mixed-use projects, owners typically agree to allocate these costs in a separate agreement based on other methodologies such as percentage of use.

B. Condominium Documents. Below is a summary of the documents that are commonly used in the creation and operation of a mixed-use condominium:

1. "Declaration." To create a condominium, a Declaration that conforms to the requirements of the Act must be filed in the real property records of the county in which the project is located. The Declaration contains important provisions including a description of the Units and Common Elements, use restrictions, and easement rights and other rights and obligations of the Unit owners similar to what would be in a set of CCRs or an REA for a traditional mixed-use development.

2. "Map." In general, the Map provides a "snap shot" of the project and it is recommended that before the rest of the Condominium Documents are reviewed, some time be spent with the Map in order to get a basic understanding of the type of project that is involved. The Map depicts not only the boundaries of the Units, but also designates the Common Elements and certain easement areas. The Map must be recorded in the real property records of the county in which the project is located either as an attachment to the Declaration or as a separate document.

3. "Allocation Document." The Allocation Document is an agreement among the owners to allocate both maintenance obligations and the related costs in a certain manner. Without an Allocation Document, the Association has the obligation to maintain both Limited Common Elements and General Common Elements and the cost of such maintenance is divided among all of the owners based on their Allocated Interests. In a mixed-use condominium, this type of "default" allocation does not always work. For example, if a pool is a Limited Common Element of the residential unit (and the retail unit cannot use the pool), an Allocation Document can provide that the residential unit owner will maintain the pool (and not the Association) and that the residential unit owner is responsible for 100% of the cost. An Allocation Document provides owners with the flexibility to fine tune cost sharing and other obligations among the owners and the Association. The Allocation Document is normally not recorded, so that it can be adjusted as necessary without having to be re-recorded. If an Allocation Document is used, it should be addressed in the Declaration as controlling as to any issues involving cost sharing and treated as a Condominium Document.

4. "Association Documents." The certificate of formation and bylaws of the Association contain information about the number and election of directors, the procedures for holding meetings and taking votes, the powers exercisable by the Association (either through the board or with a vote of the owners) and provisions indemnifying officers and directors of the Association.

5. "Regulations." The Regulations of the condominium govern the day to day operations of the condominium including noise and nuisance restrictions, leasing restrictions, signage rights and rules concerning the use of parking garages, loading docks and other facilities.

Having a seat at the drafting table is a great advantage to a party who is going to be a landlord or tenant in a condominium. Generally after the Map and Declaration are recorded it is difficult to make adjustments. Having a working knowledge of condominium basics will allow the attorney representing a landlord or tenant to diligently review the Condominium Documents and identify trouble areas that are open for negotiation for his client.

V. LEASING ISSUES UNIQUE TO CONDOMINIUM PROJECTS

A. Which Controls? The Lease or the Condominium Documents. The developer will want to ensure that all leases, contracts, and other agreements executed with or between Unit owners/landlords or tenants pertaining to the project are subject to the terms and conditions of the Condominium Documents and any future amendments to the Condominium Documents. This is typically accomplished by recording the Declaration prior to the execution of any such agreements and having the proper provisions in leases. If the Condominium Documents have been drafted correctly, they should provide that the Condominium Documents control over any inconsistent or contrary terms in subsequent agreements.

Usually, tenants enjoy the protection that well-drafted Condominium Documents provide in terms of use restrictions and uniform rules governing the maintenance and operation of the project. However, tenants with strong bargaining power will want to make sure that the terms of the Condominium Documents do not conflict with their standard lease provisions on certain issues. Therefore, prior to negotiating a lease, the tenant and tenant's counsel should review a set of the proposed or final Condominium Documents to ensure that they do not contain any provision that will prevent or unduly restrict tenant's business operations and to have a better understanding of the provisions that may or may not be negotiable.

Circumstances may arise when a developer may find it is necessary to execute a lease prior to recording the Declaration or finalizing the Condominium Documents. In these instances, it is usually in the interest of the developer to include a provision in the lease providing for the automatic subordination of the lease to the Condominium Documents upon the recording of the Declaration. The tenant may resist this, since the Condominium Documents will contain many provisions which would otherwise affect the tenant's rights under the lease. If the lease fails to provide for an automatic subordination to the Condominium Documents, but rather contemplates a subordination of the lease upon the execution of a subordination agreement, then arguably, the tenant should be required to execute a joinder to the Declaration. [See sample provision 1 in Appendix A.]

B. Control of Association. A major concern for a landlord or tenant in a mixed-use condominium is who controls the Association. By participating in the negotiation of the Condominium Documents or after reviewing the Condominium Documents, it will become apparent which Unit or Units have the leverage necessary to control the administration of the condominium by having the power to appoint a majority of the board of directors of the Association. Generally, in a project where there is a hotel, the hotel operator will demand that the owner of the hotel unit control the Association because they wish to protect the integrity of the brand. In a project that does not have a hotel component; the Declarant will normally designate the Unit in which they have the longest term interest to control the Association.

Control involves several aspects, including (i) appointment and removal of members of the board of directors and officers; (ii) amendments to the bylaws, Regulations and other governing documents; (iii) maintenance and repair of the Common Elements; (iv) preparation of an annual budget; and (v) resolution of disputes with Unit owners regarding the Condominium Documents.

The members of the board of directors, as administrators of the Association, have control over almost every aspect of the day to day workings of the condominium. Even though the board members have a fiduciary duty to make fair and reasonable decisions on behalf of the rest of the members of the Association, controlling a majority of the seats on the board of directors gives an owner (and possibly its tenant) a large advantage. Determining the budget for the Common Expenses, controlling the maintenance of the Common Elements, enforcing the Condominium Documents, granting variances to the Regulations, and collecting the Common Expenses are examples of issues that board of directors have the right to decide on behalf of the Association and the owners. Section 82.067(h) of the Act provides that the Declaration may also give the board of directors of the Association the right to: "(1) to bring an action to evict a tenant of a unit owner for the tenant's violation of the declaration, bylaws, or rules of the association; (2) to bring an action to evict a tenant of a unit owner who fails to pay the association for the cost of repairs to common elements damaged substantially by the owner's tenant; or (3) to collect rents from a tenant of a unit owner who is at least 60 days' delinquent in the payment of any amount due to the association."

Although there are only a few instances where a vote of the owners is required before an action can be taken, it is also an advantage if a Unit owner controls a large portion of the vote. Certain amendments to the Declaration, certain increases to the Common Expense budget, the termination of the condominium, and the decision to rebuild or repair the condominium after a casualty are examples of issues that owners have the right to approve with a vote.

If the landlord does not control a majority of the seats on the board of directors or owner votes, it may be more difficult for a tenant to obtain necessary approvals or variances from the Association and covenants from the landlord regarding the obtainment of the same. Additionally, a landlord should make sure that it is not obligated to take any actions under the lease that are actually obligations of the Association. To give a tenant some comfort, however, a landlord can agree to use commercially reasonable efforts to cause the Association to perform. [See sample provision 2 in Appendix A.]

C. Insurance. In a condominium that contains Units that share horizontal boundaries, which is the case in almost every mixed-use condominium, the Association has the obligation under the Act to maintain certain types of insurance, including: (1) property insurance on the insurable Common Elements, such as the structure, roof and foundation of the building, and Units insuring against all risks of direct physical loss commonly insured against, including fire and extended coverage, in a total amount of at least 80 percent of the replacement cost or actual cash value of the insured property as of the effective date and at each renewal date of the policy; and (2) commercial general liability insurance, including medical payments insurance, in an amount determined by the board of directors but not less than any amount specified by the Declaration covering all occurrences commonly insured against for death, bodily injury, and property damage arising out of or in connection with the use, ownership, or maintenance of the Common Elements and Units.[7] The insurance coverage the Association carries on the Units does not need to include improvements and betterments installed by Unit owners or tenants.

[7] Although the insurance requirements of the Act may be waived if all of the units in a project are restricted to non-residential use, it is common for a Declaration to contain the standard condominium insurance provisions contained in Section 82.111 of the Act.

Lease provisions must be tailored to take into account the insurance that the Association is maintaining and that the landlord will be named as an additional insured on such policies. Additionally, the Condominium Documents and the Association's insurance policy must be reviewed to see if the landlord or tenants that are using a Unit for a particular use are subject to any additional insurance requirements, and if so, whether the landlord or tenant will be responsible for maintaining such policies. [See sample provision 3 in Appendix A.]

D. Casualty/Condemnation. The Act and Declaration contain provisions regarding the occurrence of a casualty or condemnation event that affects the condominium. As previously discussed, since the Association has the obligation to maintain most forms of insurance that cover the Common Elements and the Units, a tenant's and landlord's option to control what happens upon the occurrence of a casualty in a condominium is more limited than the control that a landlord or tenant normally would enjoy. Under the Act, the Association has the responsibility to repair and reconstruct the condominium after a casualty event, unless at least 80% of the Unit owners vote not to rebuild (including the vote of every owner of a Unit or assigned Limited Common Element that will not be rebuilt). Additionally, the Association has the right to all insurance proceeds in order to fund the rebuilding effort as the insurance trustee on behalf of all of the owners. Upon the condemnation of Common Elements, the Association is entitled to hold and distribute all of the awarded proceeds to each of the owners in accordance with the Act. Landlords and tenants must revise their lease provisions to conform to these concepts. [See sample provision 4 in Appendix A.]

E. Defining the Demised Premises; Condominium square footages v. "leasing" square footages. In a mixed-use condominium where Units are stacked on top of one another and possibly owned by different entities, it is important for both a landlord and tenant to clearly define the boundaries of the demised premises. A landlord should specify (especially in the case where the tenant's lease form is being used) that the concept of "building" only includes the portions of the condominium that are contained in the landlord's Unit. This clarification will prevent the landlord from making covenants regarding portions of the building in which it does not have any rights. Normally, the demised premises in a lease will be a portion of a Unit. A Unit includes the airspace that is depicted on the Map and any systems that exclusively serve that Unit, but does not usually include any portion of the structure of the building. When measuring the square footage of a Unit, a paint to paint methodology will provide an accurate number. However, in typical retail leases, demised premises are normally measured using a centerline of demising wall/exterior face of external wall methodology that produces a larger square footage than the paint to paint method (i.e., interior dimensions only), and in typical office leases the BOMA measurement standards are used. Representatives of landlords and tenants should be cognizant of this difference and clearly state which methodology of measurement is being used to prevent any confusion. The boundaries of the demised premises should also include any Limited Common Elements that exclusively serve the demised premises, so that it is clear that such space is included in tenant's obligations to maintain and insure the demised premises. [See sample provision 5 in Appendix A.]

F. Use. The permitted or prohibited uses for each Unit in a mixed-use condominium are often specifically addressed in the Declaration. Owners of office or retail units must be sure that the Declaration permits the kinds of uses that will be required to attract potential tenants.

Additionally, Unit owners, their tenants and their mortgagees must make sure that the use provisions in the Declaration cannot be amended without the consent of the affected parties. [See sample provision 6 in Appendix A.]

Declarants generally impose restrictions that are usual in the market and do not affect the marketability of the Units.

In addition to any restrictions in the Declaration, the Regulations can be effectively used to govern specific aspects of the various Units by containing special provisions that specifically address concerns relating to such Unit's use. For retail units, especially those with restaurants, the Regulations can specifically address what type of establishments are permitted, venting of cooking fumes, and hours of operation, and any other issues that might create tension for the other uses in the building. Additionally, most landlords will also track these types of nuisance prohibitions in the lease for retail space. In the office leasing context, especially in mixed-use condominiums that are located in entertainment districts, most landlords add disclaimers regarding the presence in the demised premises of noise and odors from the other Units in the condominium.

G. Signage. In both retail and office leasing, the ability for tenants to post signage on the exterior of their space and possibly on the Common Elements can affect the marketability of the Unit. In mixed-use condominiums it is common for the Declarant to reserve an assignable right to post signage on all of the Common Elements (including the skin of the building). To protect this right, Condominium Documents normally provide that both the Declarant and the Association have the right to approve the type and location of signage in a condominium. If the landlord or tenant has a seat at the table when the documents are being drafted, special sign easement areas, particularly on the tenant's store front, and sign criteria should be negotiated into the Condominium Documents to protect a tenant's right to install the signage that it deems necessary. [See sample provision 7 in Appendix A.]

Section VI.F below addresses additional signage issues that are common to all mixed-use developments, regardless of whether a condominium form of ownership exists.

H. Ability to Serve Liquor. If a tenant intends to operate a restaurant, club, hotel or any other undertaking that entails serving liquor, the tenant should confirm there are no restrictions in the Condominium Documents regarding the sale or use of liquor on the premises; if such a prohibition exists, the tenant will likely face an uphill battle to have this prohibition removed from the Declaration. If liquor service or use is contemplated, the tenant should insist that the developer assist the tenant as necessary in obtaining a liquor license, including the execution of any applications or consents required to be submitted by the owner of the property to the appropriate governmental authorities. In exchange, the developer should require the tenant to obtain dram shop liability insurance naming the other Unit owners and the Association as additional insureds. [See sample provision 8.A in Appendix A.]

In some situations, the fact that the Condominium Documents currently permit or do not address the service or use of liquor in the demised premises may not provide enough comfort for the tenant; the tenant should expect adequate assurance that its business operations will not in the future become prohibited under the Condominium Documents. This issue frequently arises in

mixed-use condominiums that have both a commercial component and a residential component, which have varying interests. Certain commercial uses, such as clubs, bars and restaurants, which operate at late hours, serve liquor, generate traffic and produce excessive noise, are prone to complaints by occupants of a residential component. If an owner of a Unit does not have control of the Association, it is plausible that the other Unit owners could call a special meeting to amend the Declaration to prohibit the sale of liquor within the Units. In such cases, the tenant should insist that the Condominium Documents protect its business operations by providing that any proposed amendment or rule that would materially and adversely affect any permitted operation within the Unit would require the prior consent of the affected Unit owner. [See sample provision 8.B in Appendix A.]

I. Allocation of Expenses. Expenses incurred by the Association for utilities and insurance, as well as expenses for maintenance and repair of the condominium, constitute Common Expenses of the condominium and are funded through assessments levied by the Association against each Unit.

Regardless of how Common Expenses are allocated in the Condominium Documents, a landlord in a mixed-use condominium should ensure that it has the ability to pass its share of the Common Expenses assessed against its Unit through to its tenants, although it may not be appropriate to require a tenant to pay for those portions of the Common Expenses relating to capital costs. This is typically addressed by using the definitions and a provision in the lease. [See sample provision 9 in Appendix A.]

Tenants will often try to negotiate a cap on operating expenses. When discussing this issue, a landlord should keep in mind that just like utilities and insurance costs, the assessment of the Common Expenses is an uncontrollable expense. Including a tenant's portion of Common Expenses in a "cap" could cost a landlord a significant amount of out of pocket expenses that must be paid to the Association in order to prevent a lien being placed on the Unit.

J. Common Elements. One of the defining features of a condominium is that areas designated as Common Elements are owned in common by each owner of a Unit within the condominium, unlike "common areas" in a non-condominium development, which may be owned by a single owner or an association. An ownership interest in a Common Element does not necessarily confer the right to use a Common Element; therefore, even though each owner may own an undivided interest in the Common Elements of a condominium, each owner does not necessarily have equal rights to use the Common Elements. The significance of whether a portion of the condominium has been designated as a Unit, a General Common Element or a Limited Common Element will dictate the extent to which each owner and its tenants will have use of and control over these areas of the condominium. For example, a tenant operating a restaurant in a retail unit located within a mixed-use condominium may wish to provide outdoor seating for its patrons. Unless the outdoor area for its proposed seating area is actually a part of the retail unit or is a Limited Common Element appurtenant to the retail unit, the tenant will have no right to exclude other owners and their guests from using the outdoor seating area. This situation also arises when a tenant desires to provide valet service for its customers. Unless the area in which the tenant intends to operate valet service is part of the Unit, or unless the Declaration grants the owner the specific right to operate valet parking in this area, the tenant has no legal right to exclude the other owners from this area and the tenant may face allegations from

the other owners that the operation of the valet services interferes with their enjoyment of the Common Elements. [See sample provision 10 in Appendix A.]

K. Alterations. The designation of whether a portion of the condominium is a Unit, General Common Element or Limited Common Element will likely affect the types of alterations that can be made within the demised premises. Most Declarations prohibit owners from making alterations to the Common Elements of a condominium without the prior consent of the Association. In order to determine the extent to which this affects a tenant, the Declaration and the Map must be carefully reviewed to ascertain which portions of the demised premises constitute a portion of a Unit and which portions are actually Common Elements. If the Declaration describes a Unit as airspace (which is the typical description), then conceivably, the tenant must obtain the consent of the Association prior to the construction of any improvements to the demised premises, including finish materials which, pursuant to the Act, constitute part of the Unit. If the Declaration contemplates commercial uses, it should permit an owner to make changes to the interior of its Unit and certain Common Elements as necessary to accommodate tenant finish-outs without the consent of the Association to the extent such changes do not affect the structure of the building or any Common Elements shared with another owner, such as common walls or common utilities. The tenant should also ensure that the Declaration permits the tenant to install equipment necessary for its operation on the Common Elements, such as HVAC equipment, satellite dishes or grease traps. To the extent the Declaration does not address these issues, the tenant will likely need to get the consent of the board of directors of the Association or possibly each owner in order to make these changes to the Common Elements. The tenant should also be aware that it could be responsible for indemnifying the Declarant, the Association and the other Unit owners from liability or damage to the condominium arising from tenant's alterations to the demised premises, including mechanic's liens that may be filed on the demised premises. Most Declarations require an indemnification of this type by any owner making alterations within its Unit, and it is arguable that the obligation to make this indemnification would run to tenant making alterations within a Unit. [See sample provision 11 in Appendix A.]

L. Repair/Maintenance Obligations. In a condominium, the Association has the obligation of maintaining the Common Elements which can include exterior improvements, such as the roof, sidewalks and landscaping, and interior items, such as major mechanical systems and structural components. The maintenance obligations and repair rights contained in a lease must match the Allocation Document, Declaration, and Regulations. For example a landlord should not agree to fix a leak in the roof of the building if under the Condominium Documents the Association has that obligation, although a tenant could request the landlord to cause Association to fulfill its maintenance and repair obligations. A tenant's right to exercise self-help must also be tailored to match the Condominium Documents, but due to the large role that the Association plays in the operation of a condominium, it is unlikely that a tenant will have the right to self-help. [See sample provision 12 in Appendix A.]

M. Entry by Association (and other owners). Because the Association has such a wide variety of rights and obligations regarding the operation of the condominium, the Association generally has the broad right to enter and take certain actions in Units and on the Common Elements. Additionally, as previously discussed, the Declarant may also reserve the

right to enter and take certain actions in the Units and on the Common Elements, and the Condominium Documents may also provide that an owner can enter another Unit to remedy an emergency or to exercise self-help if the Association fails to fulfill its obligation to address a situation. These owner self-help rights may or may not be exercisable by a tenant. Lease provisions regarding third party entry rights to the demised premises and tenant self-help rights should be reviewed and conformed to match the rights that are in the Condominium Documents. [See sample provision 13 in Appendix A.]

N. Parking. Structuring the parking for a mixed-use project is an important issue that can affect each owner and their tenants. In addition to meeting governmental codes in regard to the number of available spaces, the parking design in a mixed-use project must be efficient in relation to the design of the building, as well as the types of uses in those buildings. Additionally, a sufficient amount of exclusive use parking spaces must be available to attract and serve a certain tenant mix.

There are many options for the structuring of exclusive use parking spaces in a condominium. Parking spaces may be wholly contained within the Unit which they serve, designated as a Limited Common Element appurtenant to a particular Unit, or wholly contained in a separate "parking unit." A parking unit may be owned by the Declarant or any other entity in the same manner as they would own another Unit. The parking unit owner often either enters into a separate parking agreement with the other Unit owners that sets forth each Unit's parking rights and the costs associated with that use or grants the other Unit owners exclusive easement rights to use certain parking spaces. Such easement rights can be Limited Common Elements appurtenant to a Unit. No matter what type of structure is used, the Map should be reviewed to make sure that it clearly depicts and properly reserves the parking spaces that are subject to the lease.

Section VI.B below addresses additional parking issues that are common to all mixed-use developments, regardless of whether a condominium structure exists or not.

VI. LEASING ISSUES UNIQUE TO ANY MIXED-USE PROJECT

Even if the development does not involve a condominium structure, a mixed-use project will still involve many unique leasing issues. While this paper does not attempt to address every issue which may come up in a mixed-use development, it does address many of the most common issues that landlords and tenants must address, regardless of whether a condominium exists or not. The remainder of this paper will focus on those issues.

A. Common Area Maintenance/Landlord Services. One of the most significant issues facing landlords and tenants in mixed-use leases is the proper allocation of common area maintenance expenses among the tenants of various types. To illustrate this conundrum, consider the following questions:

- In the typical vertical development comprised of a ground floor retail use with upper floor office or residential use, should the ground floor retail tenants pay a share of the cost of maintenance of the elevators in the building or the building lobby, which primarily (or exclusively) benefit the upper floor tenants? This question becomes

even more interesting if the retail tenant has its own external store front and entry to the street.

- Likewise, in a retail/office mixed-use development, should the office tenants pay for expenses that benefit primarily the retail tenant, such as after-hours lighting and enhanced security?

The answers to these questions vary by project and no definitive answer exists. The economics of the particular transaction will play a role, as will the persuasive abilities of the parties at the negotiating table. However, while negotiating the lease either on behalf of the landlord or the tenant, one should recognize that these issues exist and attempt to address the pass- through of these types of expenses in a fair and equitable manner.

1. Who Do The Services Benefit? When analyzing landlord services in the context of a mixed-use development for purposes of determining the allocation of common area maintenance expenses, it is important to distinguish between those services that may relate only to a particular use (for example, a parking garage or portion of a garage dedicated solely for the use of the residential tenants), from those which will benefit the entire development (for example, landscaping). If the service benefits only a particular use, then it is fairly easy to segregate that cost and allocate it solely to that use. However, when a particular service benefits the entire development, the analysis becomes more difficult. For example, the developer/landlord, may wish to provide landscaping for the entire development and pass the cost through to the various uses in order to maintain consistency and quality control over the entire development. While this is a reasonable approach, the real question becomes what is the appropriate allocation for each particular use?

2. The Proportionate Share Approach. In some cases, the costs are allocated on a proportionate basis based on the square footage of the particular use. While this may be a reasonable approach in some instances, in many cases it is not because some tenants are heavier users of certain services than others. For example, a restaurant use, although relatively small in terms of square footage, will be a major trash producer and will produce far more trash than a typical office or residential tenant. Therefore, the developer must either segregate those services for purposes of passing through common area maintenance costs or attribute a larger portion of the cost to that tenant than its square footage would otherwise dictate.

3. The "Trust Me" Approach. Rather than providing a mathematical formula for determining the proper allocation of expenses, many landlords/developers have instead opted for generic lease language which gives them the right to make such allocations as they deem reasonable based on the uses being made at the project. This approach understandably scares the users/tenants because the answer to the allocation question is left to the developer's judgment. However, if tempered by a reasonableness standard and right to object to an allocation which it deems to be unfair, many tenants have agreed to this approach. A potential compromise position is to provide a general formula for allocation based on square footage or some other reasonable factor, but allow the landlord/developer to make reasonable adjustments to that allocation based on its reasonable determination of the relative benefit to the particular users.

4. Beware of Hidden Costs. A final question with respect to common area maintenance costs relates to how the costs will be passed through. Depending upon the structure of the legal documentation creating the development, the lease may not provide the whole picture as to the costs being passed through to the tenants/users. There may in fact be a reciprocal easement agreement or condominium declaration that allocates certain costs which ultimately will be passed through to the tenant/user as well. In many cases, these costs were allocated prior to any leases being made in the project and there is little the tenant can do to change them. Therefore, it is recommended that a tenant/user in a mixed-use development always review all legal documentation surrounding the development in order to gain an accurate understanding of the expenses it will be required to pay.

B. Parking Issues.

1. Shared Parking Ratios. A critical feature of any successful mixed-use development is a parking plan which satisfies the needs of each of its various uses. While this can be a delicate balancing act, an attractive feature of mixed-use developments is the potential ability to share the same parking spaces among compatible uses, thereby reducing the overall parking required for the site. For example, combining an office use, where most of the tenants are gone for the day by 5:00 p.m., with a retail/entertainment component, where most of the patrons do not arrive until the evening, allows the developer the potential to share the same parking spaces for each of those uses, thereby eliminating the need for the permitting authority to impose independent parking ratios. This reduces the construction cost and eliminates vast parking fields or garages which detract from the feel of a pedestrian friendly mixed-use environment. While some municipalities are now recognizing the parking efficiencies that can be created by mixed-use developments, many unfortunately have not updated their zoning ordinances to reflect this recognition. Therefore, developers still have an uphill zoning battle when trying to get these projects approved. Nevertheless, if the developer is permitted to share parking spaces among the various uses of the complex, the lease negotiators must be careful to ensure that adequate parking for each use will be available at the times that it is needed. This may require coordination with the landlord or the parking manager in the event certain activities overlap in order to ensure adequate availability of parking and orderly traffic flow during peak times.

2. Segregation of Parking Areas. In many cases, it is common for a landlord to charge office tenants for parking. However, charging for retail or residential parking would be extremely unusual. This may require the developer to segregate the parking areas based on use. Residential parkers especially will expect to have a reserved parking space to ensure that it is available for use at any time, regardless of what else is happening in the project. Retail tenants are also sensitive to parking issues and will want to make sure that their customers have adequate parking in close proximity to their store. This can often be a challenge in a mixed-use development, so the tenant may need to consider requiring reserved parking spaces or even valet parking.

3. Comprehensive Plan. Regardless of the nature of the development, the parking plan is one of the most significant issues that landlords and tenants will encounter during the negotiation process. In fact, it is perhaps the most important issue retail tenants analyze when determining whether to lease space in a mixed-use project. Comprehensive parking rules

and regulations must be developed in order to address the varying timing, security and access needs of the diverse users. These rules must set up operational constraints to avoid "poaching" by paying office parkers on free parking use by retail customers, must ensure reasonably proximate parking for all users to their space and must otherwise accommodate the special needs of all uses in the project. In negotiating a lease, the tenant must clearly define its parking needs and ensure that the lease provides adequate remedies should those needs be violated. On the other hand, the tenant will need to understand that a mixed-use development will not provide the same parking conveniences as a traditional shopping center and therefore the tenant will need to be prepared to compromise.

C. Taxes. Similar to common area maintenance costs, an issue that often arises in negotiating leases in mixed-use developments is the method of allocation of real property taxes. In many cases, a developer is able to subdivide (even vertically) the improvements into separate tax parcels so that each of the retail, office and residential components of a particular project are separate tax parcels. Subdivision is extremely helpful in allocating taxes in the various leases. However, in a vertical development, the allocation of taxes on the land portion of the project becomes problematic because many taxing authorities will not separately allocate the value of the land among the various vertical uses. For example, in a project which includes a ground floor retail component with upper floor residential units, how should the taxes on the land be allocated? On one hand, owners of the residential units may argue that all of the taxes on the land should be attributable to the retail component, because the retail component sits on the land and would be required to pay those taxes whether the residential component existed or not. On the other hand, the owner of the retail component would argue that such an allocation would provide a windfall to the residential owners, who would then pay no taxes on the land. As with CAM costs, the landlord will need to devise an allocation which is fair and acceptable to both constituencies. Failure to do so at the commencement of the project could lead to major headaches down the road.

Another potential method for allocating taxes attributable to the land is on a proportionate basis based on the square footage of the improvements. However, this method also is not perfect, as land that is used for commercial purposes often carries a higher value than land used for residential purposes. Therefore, the residential users would argue that they are paying more than their share of the value of the land if allocated purely on a square footage basis. Once again, the developer/landlord will need to find a solution to this issue which is fair and equitable and acceptable to each of the affected parties.

One potential compromise is to allocate the taxable value of the land based on the taxable value of the improvements allocated to each use. For example, if the retail improvements carry a taxable value of $6,000,000.00 and the residential improvements carry a taxable value of $4,000,000.00, then the taxable value of the land would be allocated 60% to the retail component of the development and 40% to the residential component. While no method of allocation is perfect, many landlords and tenants have found this approach acceptable.

D. Noise, Odors and Nuisances. An important planning aspect for any developer creating a mixed-use project (especially one with a residential component) is the minimization of noise, odors, and other nuisances that may accompany commercial uses. Ultimately, the

residents will need to understand that living in a dense urban environment is a double-edged sword. While it carries many conveniences, it has some disadvantages as well. Nevertheless, the developer/landlord should make every effort to minimize the nuisance factor. In many cases this can be done by properly engineering the buildings prior to construction. For example, if the ground floor contemplates restaurant uses, the developer will want to make sure that the building is properly ventilated so that the odors from the restaurant do not eminent into the residential component. The developer may also want to engineer the building with extra barriers against sound in order to ensure that the night life at the street level of the development does not unreasonably disturb the residential tenants. Similarly, the developer/landlord will want to engineer the building so that trash storage and disposal does not create a nuisance. This will involve requiring restaurant tenants to segregate wet vs. dry trash and the development of trash chutes in order the segregate the trash in a common area, away from places where people gather. In short, the retail landlord must protect the other users of the development (such as the office tenants and the residential tenants) through the use of provisions in its retail/restaurant/entertainment leases, in order to ensure that the development is a compatible place for each of the uses. If the development is a condominium, the Condominium Documents should address these issues. If not, then these issues must be clearly addressed in the lease.

E. **Operating Hours**. Another issue which is important to the creation of a thriving mixed-use development involves the operating hours of the retail/restaurant/entertainment component. If the developer is attempting to create a "live, work, play environment", it will want to ensure that the retail tenants stay open during extended hours. If all of the stores and restaurants close at 6:00 p.m., the residents will not realize the benefits of living in a mixed-use environment. On the other hand, the developer/landlord may also want to ensure that the night life shuts down at a reasonable time in order to protect the residential tenants. While the residential tenants may not want retail establishments closing at 6:00 p.m., they likely will not want them open all night long. This can be a delicate balance and the tenant mix of the retail component will dictate what the operating hours should be.

F. **Signage**. For most retail tenants, signage and visibility are important issues in selecting a site. However, signage and visibility can be a challenge in a dense mixed-use development. In many cases, tenants will have to live with less than perfect signage options, and trust that the mixed-use development will create an environment with enough traffic to justify its location. There are several ways in which the landlord and tenant may address this issue, including exterior building signage, off-site signage and nearby billboard advertising. Most landlords are sensitive to the tenants' plight and will make every effort to accommodate a tenant's reasonable signage needs.

The landlord must also consider the effect that a tenant's signage will have on the other users of the development. The example comes to mind of the Seinfeld episode where the Kenny Rogers Roasters restaurant prevented Kramer from sleeping for several days because the neon glow from its sign turned his entire apartment red. As with most Seinfeld episodes, this scene was humorous because many people have had a similar experience. In order to prevent this from occurring, the landlord must balance the retail tenants' desire to draw people to its store with bright lights against the residential tenants' desire to control its own internal environment.

G. Access and Deliveries. Mixed-use developments also create issues regarding the access of the various users to their space. For example, residential users will need unrestricted access to their home, while office tenants will want to restrict access to their space after hours. If both uses are located in the same building or use the same elevators, this creates an operational issue.

In addition, it is extremely important for the landlord in a mixed-use development to regulate the timing and location of deliveries to the various components of the project. This will require the management company to coordinate deliveries and schedules, especially if the various uses share a common loading dock. For example, the retail/restaurant uses may require daily deliveries at a specific time. On the other hand new residential tenants moving into the building may have more flexibility in terms of their need to use the freight elevators or loading docks. Ultimately, this is a coordination issue, but the leases must specify the rights of the parties with respect to access and use of the common loading areas.

The landlord may also want to restrict the access of contractors to the project to specific hours. The residents will certainly object to construction of an adjacent office or retail space which begins before 7:00 in the morning. On the other hand, the office or retail tenant will want to perform its construction during non-peak hours, which often will conflict with the hours that the residents are at home. Therefore, the landlord will need to manage expectations and balance the competing objectives of the various components of the project. These restrictions on construction must be included in the leases in order for the landlord to properly manage this process. Although residents may understand that living in a mixed-use environment will necessarily involve interaction with commercial uses, they will want to attempt to make uses compatible with the residential life-style.

H. Other Exterior Restrictions. In order to maintain a symbiotic relationship between the uses, the landlord/developer must regulate the use of the common areas in a way that will create the environment which the developer/landlord seeks to establish. The landlord may want to restrict store fronts and window displays of the retail tenants, or establish view corridors and easements to ensure the desired aesthetic. This may also involve allowing restaurant tenants to use a portion of the common areas for outdoor seating, or allowing retail tenants to display merchandise on the sidewalks for so-called "sidewalk sales". While allowing such use can add charm and character to the development, it also creates several issues which must be addressed in the lease. If such uses are allowed, the lease should be absolutely clear as to how and when the space may be used, whether the tenant is paying rent on such space, insurance and indemnity obligations relating to such use and the like.

I. Use Issues. By definition, a mixed-use project will allow more uses than is typical in a standard retail shopping center. However, that does not mean that the individual users of the space are not concerned about the use being made in other areas of the project. For example, residential users will be concerned about any use which adversely affects the quality of their residential life. Likewise, retail tenants will continue to be concerned about uses, such as restaurants and theatres, which will have an adverse impact on parking in the development. Therefore, although more uses may be allowed in a mixed-use project, the developer/landlord may find it necessary to identify areas within the project which will be exclusive to certain uses.

In addition, uses which may be undesirable in a typical retail shopping center, such as doctor offices, travel agencies or other service providers, may very well be desirable in a mixed-use context because of the residential component. As a result, it is impossible to determine what are desirable uses and undesirable uses in a mixed-use development until the components comprising the development are fully understood. After all, by definition, each mixed-use development is designed to create a neighborhood that is unique unto itself.

J. **Security**. Another important issue to consider in the mixed-use development is security. Regardless of whether the development is under one ownership or common ownership, it is important for the landlord/developer to maintain a consistent and uniform approach to security. Therefore, a central security force which patrols each of the various components of the development is critical. This enables the developer/landlord to maintain consistency among its security cameras, enforcement of rules and regulations and the like. The cost of security should be treated as a common area maintenance expense an allocated to the various components as discussed in that section of this paper.

VII. CONCLUSION

Mixed-use development is an exciting component of today's real estate market. Because of its popularity, many developers who have historically focused on a single product type are being forced to deal with issues that are foreign to them. Likewise, many tenants who have historically located in single use developments are now being required to adjust their practices to accommodate the needs of different uses. This presentation has examined many of the issues to be considered when negotiating a lease in a mixed-use project. As has been shown, the introduction of a condominium form of governance further complicates the issues, because the rights and obligations of the parties are covered not only in the lease, but also the Condominium Documents. In any event, because of the density and interdependence of the uses within such a development, both landlords and tenants will need to enter the negotiations and a relationship with a spirit of cooperation and compromise. Retail tenants may not enjoy every benefit they have been accustomed to in a typical shopping center environment. Landlords will need to take extra precautions to protect the tenants from disruption which may be caused by other users of the project. If the developer does not create a complimentary tenant mix with adequate protection for the various components, or the tenants do not share the vision of the landlord for the project, the development is destined to fail. However, careful documentation and a spirit of cooperation will solve most of these issues and lead to a beneficial relationship for all parties involved.

APPENDIX A

SAMPLE PROVISIONS

1. Subordination of Lease to Condominium Declaration.

"This Lease is subject and subordinate to all matters now or hereafter filed of record in the real property records of _____County, Texas (collectively, "Matters of Record"), including the [CCRs,] [the Declaration] and any restrictive covenant, easement agreement, condominium declaration or other instrument and any and all amendments thereto. If the Property, the Building, the Premises or any portion thereof is now or hereafter becomes subject to a condominium development, then Landlord's obligations in this Lease, including any repair or maintenance obligation, shall be modified to give full effect to the terms of the Condominium Documents."

"The Premises is part of a condominium development known as _____, a Condominium (the "Condominium"), which Condominium consists of a retail unit owned by Landlord (the "Retail Unit") and _____ Residential Units owned by third parties (the "Units"), and common elements appurtenant to the Retail Unit and each of the Units ("Common Elements"). The Premises is a portion of the Retail Unit of the Condominium, which includes the mechanical, electrical and plumbing systems which exclusively service the Retail Unit. The Condominium is managed by an association of owners of the Units therein (the "Association"). The condominium is subject to the terms of a Declaration, rules and regulations established by the Association, and certificate of formation and bylaws of the Association (collectively, as amended, the "Condominium Documents"). Tenant agrees to comply with the terms and provisions of the Condominium Documents with respect to its use and occupancy of the Premises including the appurtenant Common Elements and exercise of its rights and performance of its obligations under this Lease."

2. Landlord Obligations with Respect to Condominium.

"If any Condominium Document allocates to the Association or other entity the responsibility for an obligation that Landlord otherwise has under this Lease, then Landlord shall be relieved of such obligation and instead shall be obligated to use commercially reasonable efforts to cause the Association or other entity to carry out such obligation according to the terms of the applicable Condominium Documents."

3. Insurance Requirements.

"Tenant acknowledges that property insurance and commercial general liability insurance as to the Common Elements and Units of the condominium is to be obtained and maintained by the Association pursuant to the Condominium Documents and not Landlord. Landlord shall not have the obligation under this Lease to obtain any insurance; provided, however, that Landlord shall carry such insurance as it deems prudent for its ownership and operation of the Unit. To

the extent that the Condominium Documents require additional amounts or types of insurance to be carried by a Unit owner, Tenant shall promptly obtain and maintain all such insurance with respect to the Premises, at Tenant's sole cost and expense."

4. Casualty.

"Tenant shall give immediate written notice to Landlord and the Association of any damage caused to the Premises or the Building by fire or other casualty. If the Premises and/or Building are hereafter damaged or destroyed or rendered partially untenantable for their accustomed uses by fire or other casualty, Tenant acknowledges that pursuant to the Condominium Documents, the Association has the responsibility to restore the Common Elements to the extent provided in and in accordance with the provisions thereof. After completion of the reconstruction or repair by the Association as described above, Tenant shall promptly commence and diligently pursue to completion, repair and replacement of its merchandise, trade fixtures, furnishings and equipment and shall rebuild, repair or replace the Premises (including all improvements described in the Lease as Tenant's responsibility to maintain) in a manner and to at least a condition equal to that prior to its damage or destruction. From the date of such casualty until the Association completes its restoration of the portion of the Common Elements necessary for Tenant to perform its restoration obligations, Minimum Annual Rental payments and all items of additional rental, except taxes and insurance premiums, shall abate in such proportion as the square footage of the Premises thus destroyed or rendered untenantable bears to the total square footage of the Premises. In the event that the Premises is destroyed or rendered untenantable by fire or other casualty during the term of this Lease to an extent that the Association will not rebuild the Common Elements; then either Landlord or Tenant shall have the right to terminate this Lease effective as of the date of such casualty, by giving the other party, within 180 days after the date of such casualty written notice of such termination. If said notice is given within said 180 day period, this Lease shall terminate and Minimum Annual Rental and all other charges and items of additional rental shall abate as aforesaid from the happening of such casualty, and Landlord shall promptly repay to Tenant any rental theretofore paid in advance which has not been earned at the date of such casualty. In the event of such a termination of this Lease, the proceeds of Tenant's property insurance policies (other than with respect to Tenant's personal property and trade fixtures) shall be paid to and retained by Landlord. Except as herein expressly provided to the contrary, this Lease shall not terminate nor shall there be any abatement of rental or other charges or items of additional rental as the result of a fire or other casualty."

5. Measurement Methodology.

"The Premises is a portion of the Retail Unit of the condominium, which includes the mechanical, electrical and plumbing systems which exclusively service the Premises. Tenant acknowledges that the methodology utilized to determine the square footage of the Premises as described in the Lease differs from the methodology utilized to determine the square footage of the Unit in the Condominium Documents."

6. Protection of Permitted Use.

"Unless Tenant otherwise consents, Landlord shall not execute, consent to nor otherwise permit the execution of any document comprising part of the Condominium Documents where such document contains a provision which is materially adverse to, inconsistent with or would otherwise materially change the use of the Premises permitted under this Lease."

7. Signage.

"The owner of the Retail Unit shall be permitted to place or permit on its respective exterior doors or windows visible from the exterior of the condominium, signs, awnings, canopies, advertising devices, decorations, lettering or other identifying materials, so long as such signs or other advertising or identifying materials, size and location comply with the [sign criteria]. If the owner of the Retail Unit installs or permits the installation of any signage or identifying materials in violation of such sign criteria, the Association shall have the right to remove the same, at the owner's expense, after the giving of five days' prior written notice. The owner of the Retail Unit (at its expense) shall be responsible for (i) obtaining and maintaining all necessary permits and approvals required, both under applicable governmental requirements and otherwise, with respect to the erection and maintenance of any signs or identifying materials outside the Retail Unit, (ii) keeping and maintaining, or causing to be kept and maintained, any such signs in good condition and repair, and (iii) keeping or causing to be kept all lighting and other equipment in connection with any such sums in good working order and condition."

"In connection with the Skin Easement, both the Residential Unit Owner and the Retail Unit Owner shall have the Signage Rights with respect to the Skin immediately adjacent to such Owner's Unit. All signage erected on the Property shall (a) be in compliance with the Restrictive Covenants and the Legal Requirements, and (b) shall neither be flashing signage or produce a disturbing noise unless otherwise agreed in writing by each Owner, provided, however, that the Retail Unit Owner shall have the right to erect any and all signage of a national tenant leasing space within the Retail Unit, which such signage shall be automatically deemed approved by the Residential Unit Owner and Declarant."

8. Ability to Serve Liquor.

A. "Any and all operators of restaurant or other retail operations within the Retail Unit that are selling or serving liquor or alcoholic beverages of any type or nature shall be required, as a condition precedent to the sale or distribution of any such liquor or alcoholic beverages from any space within the Retail Unit, to obtain such dram shop and/or other liquor liability insurance coverage as is then customary for comparable restaurant or other retail establishments situated in comparable first class, mixed-use developments in the City of _____, Texas, naming the Association (for the benefit of the owners) and, if the Retail Unit Owner elects, any owner and/or occupant of a unit in the condominium as additional insured thereunder."

B. "The owners of the Units shall not intentionally interfere with the efforts of the owner of the Retail Unit or its tenant to obtain a liquor license from the City of _____, Texas and/or any other applicable governmental authority for restaurant or other applicable retail

operations within the Retail Unit. It is the Declarant's intention that the Retail Unit operates independently from the Units and free from unnecessary interference by the condominium Unit owners. Any amendment of this Declaration or the imposition of any rule or requirement not contained in the Regulations or other Condominium Documents that materially and adversely affects the Retail Unit shall require the consent and approval of the Retail Unit owner."

9. Allocation of Expenses – Definitions.

"Condominium Assessments: All sums assessed against the Unit pursuant to the Condominium Documents."

"Tenant's Share of Condominium Assessments: A fraction, the numerator of which is the rentable square footage of the Premises and the denominator of which is the total rentable square footage within the Unit."

"Condominium Assessments. Tenant shall reimburse Landlord for Tenant's Share of all Condominium Assessments which at any time prior to or during the Lease Term are assessed with respect to the Unit, or any part thereof or any appurtenance thereto. Tenant's Share of Condominium Assessments during the first and last years of the Lease Term will be prorated between Landlord and Tenant based on the actual number of days in such years within the Lease Term."

10. Outdoor Seating/Valet Parking.

"The owner of the Retail Unit shall be entitled to maintain and operate and/or to permit the maintenance and operation of restaurant seating areas on the outside sidewalk spaces immediately adjacent to any restaurant operations within such Retail Unit; provided, that the dimensions, design and operations of any such outside seating area will comply in all respects with all applicable laws, ordinances and regulations and provided, further, that each of the owners of Units agrees not to interfere with any owner of the Retail Unit in connection with the use of its Retail Unit or application for, and procurement and maintenance of, any and all permits required with respect to such outside seating areas under any such applicable laws, regulations or ordinances."

"In order to accommodate the operation of the Units, portions of the sidewalk area situated immediately outside the Retail Unit may be utilized for valet parking stands and/or operations, in order to allow for the valet parking of cars and other vehicles of the customers and guests of such Units; provided, that any such valet parking shall only be permitted in compliance with these Regulations and any and all parking regulations promulgated by the City of _____, Texas and all other Legal Requirements. The Owner of the Retail Unit shall operate (or contract for the operation of) the valet parking service, which may include, at such Owner's discretion, a charge imposed upon the vehicle operator for the use of valet parking."

11. Alterations.

[DECLARATION]

"From time to time throughout the term of this Declaration, the owners of Units and the Association shall, upon the request of the owner of the Retail Unit (but subject to the terms and conditions of this Declaration as may be otherwise applicable), execute and agree to such consents, authorizations, plans (to the extent consistent with the approved plans of the condominium) as are reasonably requested by the owner of the Retail Unit to complete the build out of the rentable space within such Retail Unit; provided, however, (i) any such documents, consents, authorizations, and/or plans requested to be agreed to and/or executed by the owners of Units and/or the Association shall be in form and content approved in writing by such parties in advance and (ii) neither the owners of Units nor the Association shall be required to incur or undertake any expense, liability or responsibility pursuant to this paragraph."

[LEASE]

"The prohibition on alterations contained in this Lease applies to the Premises (including the Limited Common Elements). In making any such alterations, to the extent Tenant is required to obtain the written consent of Landlord, Tenant must also comply with the applicable provisions of the Condominium Documents."

12. Repair and Maintenance.

"Tenant acknowledges that the Condominium Documents provide that the Association is responsible for maintaining the structural components of the Building containing the Premises and certain other Common Elements of the condominium, including the roof, foundation, the structural soundness of the exterior walls (excluding all windows, window glass, plate glass, and all doors of the Premises), in good repair and condition and that Landlord has no obligation to repair or maintain the Premises, the Building, the Common Elements, the condominium or any part thereof. Tenant shall promptly notify the Association and Landlord of the need for any such work. Landlord shall use such efforts as it deems appropriate to cause the Association to maintain such elements in accordance with the terms of the Condominium Documents."

"Tenant's obligation to maintain and repair the Premises shall include the obligation to maintain doors and utility and mechanical equipment which exclusively serve the Premises. Tenant agrees to comply with the requirements of the Condominium Documents in connection with repairing and maintaining the aspects of the Premises which are Tenant's responsibility to repair and maintain pursuant to the Lease."

"Tenant's installation, repair, restoration and removal obligations and requirements set forth in the Lease shall also apply to any applicable portions of the Common Elements and Building, in addition to the Premises."

13. Entry by Association.

"Upon paying the Rent and performing the terms, covenants and conditions of this Lease, Tenant shall quietly have, hold and enjoy exclusive possession of the Premises and all rights granted Tenant by this Lease, provided that Landlord and the Association shall have the right to enter upon the Premises at any reasonable time after 48 hours prior written notice (except in an emergency in which case such advance notice, will only be provided if reasonable under the circumstances) for the purpose of: (a) inspecting the same, (b) making repairs to the Premises required of Landlord or the Association hereunder or under the Condominium Documents, (c) making repairs, alterations or additions to other areas of the condominium, or (d) showing the Premises to prospective purchasers, tenants (during the last six months of the Term only) or lenders. This Lease, however, shall not be deemed to impose any obligation upon Landlord or the Association to enter the Premises, except if and to the extent that any such obligation may be specifically required pursuant to another express provision of this Lease."