
<p style="text-align: center;">MIXED USE DEVELOPMENT OPERATING AGREEMENTS A Developer's Perspective</p>
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In preparing documentation to plan, create, construct, govern and operate mixed-use developments, the best way to start is with a clear understanding of the place. As you begin to describe the site and what you plan to build, you will find many similarities to traditional shopping centers, office parks and residential condominium developments. Yet, the differences will quickly emerge as you realize that the typical concerns of unit owners, retail tenants and office employees need to be blended with and balanced against the realities of the development constraints and the needs of the local governments that will approve the plans. These matters are challenging enough in separate commercial centers, but when combined in a single site plan, the experts advise that the only way to make it work is to build as much flexibility as possible into the documents.

Not only should you start with a detailed site plan showing the physical location of various structures and other improvements and areas that will be a part of the development, but you will need to determine the level of public, shared, or private uses that will occur so the operational and maintenance expenses may be fairly assessed. These key components include: roadways; parking lots and garages; transit areas; public art; restrooms; information areas/concierge; driveways; sidewalks; landscaped areas; fountains; loading docks; signage; outdoor dining areas; amenities, such as fitness areas and pools; lobby and elevator areas; passenger and service elevators; trash collection and removal areas; roof spaces; tunnels and off-site improvements for which the project is responsible. Only when you have a good idea of the project vision as a whole, are you ready to start planning to draft documents.

I. COMMUNITY GOVERNANCE OPTIONS

From the master developer's perspective, one of the most critical decisions is how the development will be governed. The following represents a brief summary of some of the available governance structures and other assessment vehicles:

Operation, Maintenance and Reciprocal Easement Agreement

This involves the property being subjected to master covenants without a master association, and then separated into individual parcels or clusters, each of which may be subject to a separate condominium regime and separate association.¹ A cost sharing arrangement would fund shared facilities, and enforcement of property covenants and restrictions would be handled directly by the owners pursuant to their agreement. The developer or group of developers would retain and own the project common areas, such as private roads, parking structures and landscaped areas, and it would grant an easement in favor of the applicable associations. An easement fee would be charged to each association to cover the developers' costs to maintain the shared common areas, while the control of those areas remains strictly with the developer(s). None of the associations or their members would have the right to provide input or vote on the use of common areas unless the terms of the easement were violated.

¹ See Arizona Revised Statutes, Sections 33-1201 et seq.

This arrangement is desirable for a mixed-use property with separate retail, residential and office developers and major retail anchors, in addition to governmental authorities who may participate if the property is part of an urban redevelopment plan. It allows for the parties to enter into any number of agreements to address the specific impacts that their operations cause to other users, which is particularly important in the event of a casualty loss. The downside to this approach is the lack of a clear exit strategy for the developers, but at least no one developer remains responsible for the final outcome.

Master Association/Declaration with Subordinate Condominium Associations

This structure also includes master covenants or declaration and provides a master entity to handle the high level design review and lifestyle creation for the development and provision of services and facilities that are shared by all users. All amenities to be shared among the various users within a project would be designated as master common areas under the declaration, and the master association would own and have exclusive management and control over those common areas. Representation on a master association board of directors should be available to all user categories. This approach is typically combined with separate condominium associations that are responsible for individual buildings or other groups of condominium units. While each subordinate association would have a right to be consulted on major decisions affecting use of shared facilities and services, and perhaps would be permitted to vote on certain matters, the master association would be designed to vest perpetual control in a board selected by the developer(s).

All amenities and common elements located entirely within an individual condominium regime would be governed by that regime and its association. Assessments would be imposed by the master association against the subordinate condominium associations, who in turn would assess their members for their portion of the costs to maintain the master common areas, in addition to assessments necessary for their own operating and capital reserve budgets.

Under this structure, the subordinate condominium associations may be created based upon location or use, as follows:

Governance by use- such as a retail condominium association, a residential condominium association and an office/hotel condominium association. Each association would provide facilities and services used only by its members within the areas reserved for their particular uses. This approach may generate conflicts between members of each user group located in different buildings and with different circumstances, and may leave some areas such as roofs unallocated to any responsible party other than the owner of the underlying land or shell building owner if the building was sold or leased separately. It would not be desirable to assign responsibility to these isolated building areas to the master association.

Governance by geography- an association for a particular building would provide facilities and services used by all user categories within the defined building area. This would require a mechanism to mediate disputes among different user groups within the same building, although the building association would have ultimate responsibility for all shared common elements within the building.

Master Condominium with Subordinate Condominium Associations

This would be a similar structure to the master association concept, but allows creation of a condominium unit for each building footprint area that would be managed by the master association acting as a condominium association. One or more developers who own the master condominium units may further subdivide those units into smaller units for end users or may simply designate spaces within the single condominium unit for lease to retail tenants. The master condominium association would also perform the typical master association responsibilities for the project as a whole.

Community Facilities Districts

These financing vehicles for public improvements are not unique to mixed-use developments and historically are commonly used to finance infrastructure for residential developments. If general obligation bonds are issued each owner will pay assessments established by a district board based on assessed valuation and collected in the same manner that property taxes are assessed. Revenue bonds may be issued if approved by the local jurisdiction and repayment would come primarily from sales tax revenues generated by the development.

In all of these structures, it is critical to maintain as much flexibility as possible to allow the property to evolve and change over time to keep pace with the market conditions and allow the development to compete with newer properties. In all instances, interested parties who will help define the structure include: local governments; tenants/purchasers; building owners; parking owners; design review committee; developers’ consulting teams and developers’ marketing teams.

II. LEGAL STRUCTURE COMPARISON CHART

To make it easier to understand the differences between the two models discussed, the following chart provided by Greenburg Traurig L.P. compares the most important features.

CATEGORY	MASTER AND SUB-ASSOCIATION	CLUSTER ASSOCIATIONS WITH REA COVENANTS
Structure	Master covenants and several sub-association declarations designed to work together.	Master covenants, several condominium declarations and reciprocal easement agreements.
Control	Everyone votes on shared amenity features at the master board level but the master board can perpetually control the member sub-associations. The most democratic approach, but with developer control built in.	Developer(s) reserves absolute control over all shared elements. Owners of condominium units vote only in their owner’s association.
Meetings/Voting	Multiple association meetings: one association meeting per component and one master. Voting on two levels.	One association meeting per component. Voting on one level.
Association	Higher administrative costs	Lower costs because there is

CATEGORY	MASTER AND SUB-ASSOCIATION	CLUSTER ASSOCIATIONS WITH REA COVENANTS
Administrative Costs	to maintain associations, distribute minutes and statements every month. Additional management fees are required.	only one association and one level of manager per component.
Marketing	Multi-level administration and voting arrangements are more difficult for purchasers to understand.	Less difficult to market one association membership to purchasers.

Construction defect or other litigation risks	Less desirable for developer liability, as more entities have standing to sue: one association per component and master.	Only one association per component has standing to sue.
Enforcement of Assessments	Easier to enforce assessment liens for master common area (shared amenity) expenses because direct, non-judicial liens can be utilized against unit owners through the sub-associations.	More difficult to enforce assessment liens for shared amenities because enforcement only achieved by a judicial action by the easement owner against each association.
Subordination by Lender to Regime	Lender must subordinate or enter into non-disturbance arrangements in favor of master and individual condominium regime covenants.	Lender must subordinate or enter into non-disturbance arrangements in favor of individual condominium regime covenants and shared amenity easements.

III. SAMPLE DOCUMENT CHECKLISTS

The following are preliminary checklists of the action and/or documents required for each type of structure in preparation for the launch of a mixed-use project, together with parties who should be responsible for each. The applicable laws of the target sales jurisdictions should be taken into consideration in finalizing the project structure.

A. MASTER/SUB-ASSOCIATION DOCUMENT CHECKLIST

ACTION/DOCUMENT	Responsible Party	COMMENTS
1. Master Declaration of Covenants, Conditions and Restrictions	C	Common rules for entire Project, management and maintenance of shared amenities and allocation of costs for the same among all Project elements
2. Master Association Bylaws	C	
3. Master Association Articles	C	
4. Master Association Rules and Regulations and Design Standards	C/D	
5. Condominium Declaration	C	Adapt for each parcel/cluster
6. Condominium Sub-Association Bylaws	C	Adapt for each parcel/cluster
7. Condominium Sub-Association Articles	C	Adapt for each parcel/cluster
8. Condominium Sub-Association Rules and Regulations	C	Adapt for each parcel/cluster
9. Condominium Plan	C/P/D	Adapt for each parcel/cluster
10. Final Subdivision Plat (s)	C/P/D	Parcelization of entire Project land
11. Consumer Purchase Agreement, Escrow Instructions and Receipt for	C	Commercial, residential or hotel condos

Returnable Deposit (Cash, Credit)		
12. Consumer Secured Promissory Note	C	Commercial, residential or hotel condos
13. Consumer Mortgage/Deed of Trust	C	Commercial, residential or hotel condos
14. Reservation Agreement and Receipt for Returnable Deposit	C	Commercial, residential or hotel condos
15. Individual Rental Agreement	C	Commercial, residential or hotel condos
16. Condominium Deed	C	Commercial, residential or hotel condos
17. Disclosure Statement	C	Commercial, residential or hotel condos
18. Receipt for Consumer Documentation	C	Commercial, residential or hotel condos
19. Closing Statement	C/D	Commercial, residential or hotel condos
20. Escrow Deposit Agreement (Reservation, Purchase)	C	Commercial, residential or hotel condos
21. Condominium Property Management Agreement	C	All condo regimes, separate agreements but common management
22. Hotel Management Agreement	C	Hotels
23. Hotel Optional Services Agreement	C	Condo hotels or residences with hotel services
24. Developer Inventory Rental Agreement	C	Condo hotels
25. Association Rental Agreement	C	Condo hotels
26. License Agreement	C/D	Hotels, condo hotels, residences
27. Marketing and Listing Agreement	C/D	All products for sale/lease
28. Commercial Leases	C/D	Commercial/retail
29. Parking Leases/Agreements/Easements	C/D	Attach parking rights to products for sale, reserve parking for particular uses

D = Developer
 C = Counsel
 P = Planner

B. ASSOCIATION CLUSTERS/EASEMENT MODEL DOCUMENT CHECKLIST

ACTION/DOCUMENT	Responsible Party	COMMENTS
1. Final Subdivision Plat (s)	C/P/D	Parcelization of entire Project land
2. Declaration of Covenants, Conditions and Restrictions (Association 1 - Residential, Commercial, or Mixed-Use Condominium)	C	Requires discussion and analysis of amenities of different components, cost allocation and control issues. Can be duplicated for other condominiums created.
3. Condominium Association Articles (Association 1)	C	
4. Condominium Association Bylaws (Association 1)	C	
5. Rules and Regulations	C	Adapt for each parcel/cluster

ACTION/DOCUMENT	Responsible Party	COMMENTS
(Association 1)		
5. Declaration of Covenants, Conditions and Restrictions (Association 2)	C	
6. Condominium Plan	C/P/D	Adapt for each parcel/cluster
7. Condominium Association Articles (Association 2)	C	
8. Condominium Association Bylaws (Association 2)	C	
9. Rules and Regulations (Association 2)	C	
10. Shared Amenity Easement (Amenities/ Parking, etc.)	C/D	Major instrument for control and cost allocation over shared amenities
11. Condominium Deed.	C	
12. Disclosure Statement	C	Commercial, residential or hotel condos
13. Receipt for Consumer Documentation	C	Commercial, residential or hotel condos
14. Closing Statement	C/D	Commercial, residential or hotel condos

15. Escrow Deposit Agreement (Reservation, Purchase)	C	Commercial, residential or hotel condos
16. Condominium Property Management Agreement	C/D	All condo regimes, separate agreements but common management
17. Hotel Management Agreement	C/D	Hotels
18. Hotel Optional Services Agreement	C	Condo hotels or residences with hotel services
19. Developer Inventory Rental Agreement	C	Condo hotels
20. Association Rental Agreement	C	Condo hotels
21. License Agreement	C/D	Hotels, condo hotels, residences
22. Marketing and Listing Agreement	C/D	All products for sale/lease
23. Commercial/Retail Leases	C/D	Commercial/retail
24. Parking Leases/Agreements/Easements	C/D	Attach parking rights to products for sale, reserve parking for particular uses

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IV. KEY PROJECT DECISIONS

Finding the Best Structure for Your Project

An open dialogue with the project team will help lead to the best conclusions about governance structure and provide the information necessary to draft documents based on the facts and circumstances for your particular property:

Who is the decision-maker regarding the substantive issues affecting the development as a whole?

If a single developer, all decisions regarding development and construction may be simplified, but there is a risk that input from critical stakeholders will be lacking. If multiple developers or major retail tenant/purchasers are involved, collaboration on the development and construction schedule and governing documents will be required. If multiple parties are constructing and financing portions of the project, a joint development agreement is appropriate. The discussion should cover allocation of responsibilities for various improvements, coordination and scheduling of construction, construction management, design approval process, securing government approvals and permits, contracting for utility services, risk management and insurance requirements, and default remedies. Finally the roles of all parties in community governance must be addressed.

Is the development as planned consistent with zoning and land use regulations and is phasing consistent with planned timing of occupancy permits? Is the development, as planned, consistent with Arizona law and local building codes regarding creation of a condominium and does this limit flexibility on assessments for common expenses and voting control of the condominium association?

Pay particular attention to the subdivision issues and required separation between buildings that will be separately owned.

Would the building owner prefer that certain types of charges and maintenance responsibilities remain its business responsibility and be assessed as a user fee or lease expense outside the common expense structure in the governing documents?

Construction defect litigation risks may be lessened if the building's physical plant and basic building services are handled outside the association structure.

What is being governed and how interdependent are the various uses and areas within the development? Is there a dominant use or are the uses equal in importance?

Each must be respected to allow the residential users quiet enjoyment subject to the covenants, and the retail and office users the reasonable opportunity to operate their businesses as planned.

Are there any retail uses not typically mixed with residential and office that create special space needs, such as grocery stores, or big box retailers?

Consider how shopping cart management could become a major area of dispute within a mixed-use center.

How are the shared areas treated?

Generally limit reserved easements to matters where interaction between uses is reasonably anticipated, and the uses don't adversely impact other owners and users.

How will the property be subdivided?

Define the physical boundaries and real estate interests of all areas and parties.

Who will be assessed to maintain common areas, and what are the major shared facilities?

If the project includes major amenities such as a community theater or fitness center, in some instances all parties should contribute to the cost of upkeep for the well-being of the project as a whole, particularly where office, retail and hotel employees will have access to those amenities.

Will utilities be separately metered or sub-metered?

For example, chilled water systems can be very beneficial, but only the users connected to the system should be charged.

How will desired separation between common areas for different users be maintained- ie., separate entrances, elevators, utility systems, parking areas, loading docks, trash removal etc. to avoid potential disputes?

Private access and security will be particularly important to achieve maximum value for the residential units. The developer's desire to have night life in the center may conflict with the peaceful occupancy by residents unless the proper attention is paid to sound proofing and light levels.

Are there site specific constraints requiring special attention such as underground parking in a flood plain?

Engineers should remain a key part of the project team long after the plat is complete to avoid costly mistakes.

What types of use restrictions are desired by the master developer to fulfill its commitments to various user groups?

Use restrictions need to align closely with the project vision and marketing messages.

V. OPERATIONAL CHALLENGES

Cost Sharing

A major issue for office and retail users will be fair allocation of project expenses in a mixed-use setting. Floor area or land area fractional allocations to allocate common area expenses and not effective in a vertical development. It is also extremely difficult to measure the level of each party's use of particular project facilities and services, nor is it possible to have a financially viable project if major users are excluded from common area charges. One solution is to select an agreed upon minimum denominator to use in establishing each user's proportional share of common expenses. The minimum number could increase over time as the development expands.

The allocation method that is selected at the outset may not continue to be fair in later phases of the project after expansion of certain uses occurs. These expansions typically impose additional parking needs. The documents should specify to what extent approval of an expansion plan is conditioned on the opening of new parking by the benefited party to accommodate the expansion area.

Infrastructure and podium building support that benefits a developer construction vertical expansion of an existing building should require repayment to the owner who constructed the initial building area. Timing of payments can be tied to when the party paying receives the benefit of the earlier work.

A gap may be created between CAM charges to be paid by building tenants under retail leases and assessments against a building owner by the condominium association (and possibly the master Association). For a new project, tenants will agree to specific lease expenses as early as the letter of intent stage, and often due to lender pre-leasing requirements or market competition, the leases may be negotiated well in advance of the establishment of an operating budget by the association. Inconsistencies will be resolved in favor of the declaration, and building owners should be alert for the impact of these gaps on their project proformas.

Construction Risk Management and Insurance

A coordinated approach to construction risk management is essential to a project's success, especially with multiple developers involved in the construction process. A common strategy is to place the responsibility for insuring that all parties involved accept their share of the responsibility for risks and insurance in the hands of a construction manager. All of the interested parties listed above will want to be protected from liability caused by the actions of others involved in the complex multi-party effort to design and complete the construction.

The types of insurance typically required during the construction period include:

Commercial General Liability: For construction this is often provided in an OCIP (Owner Controlled Insurance Program) or "wrap" policy. This protects the named insureds and additional insureds from third-party claims for property damage and bodily injury. With wrap protection, all outside parties are directed to the same policy limits to cover claims. The parties included in the wrap typically are not able to sue each other, preventing excessive attorneys' fees and costs resulting from cross suits. A special wrap addendum is required for construction contracts and subcontracts. The cost is less than separate coverage for each of the named parties, but the limits are

shared and self insurance or deductible amounts may be required from all participating when a claim arises regardless of fault.

Builder's Risk: This provides hazard insurance protection against loss of the construction materials and other property used in the construction work in process prior to completion and issuance of a certificate of occupancy.

Worker's Compensation: This type of policy provides compensation to employees who are injured at work. Claims are paid whether or not the employer is negligent. These coverages are mandated by state law and developers should monitor the compliance of contractors and their subcontractors with the legal requirements.

In the mixed-use setting, a special challenge is getting design professionals who are used to working only in the commercial construction world comfortable with the risks of a building that includes residential condominium units to be sold to end users. This is seen as a very high risk area for construction defect litigation, and a best practice to increase the comfort level of everyone involved with the project is to engage the services of a highly experienced construction quality assurance inspection firm throughout the construction phase of the project.

Conclusion

Master and subordinate governance entities, developers and management companies representing various groups need to avoid discrimination against particular groups of users in making project development decisions, in issuing rules and engaging in enforcement activities. These challenges continue long after the mixed-use center is open. Many of the day to day decisions that can lead to conflict involve special events and use of outdoor spaces. Other key areas requiring focus to avoid disputes include parking, signage, security, and allocation of costs for expanded facilities. To enhance the likelihood of acceptance of standard practices by the entire community, the key is plenty of preparation, advance notification, education and frequent communication with all unit owners and users.