

THE MIDWEST'S REAL ESTATE SOURCE

# HEARTLAND REAL ESTATE BUSINESS®

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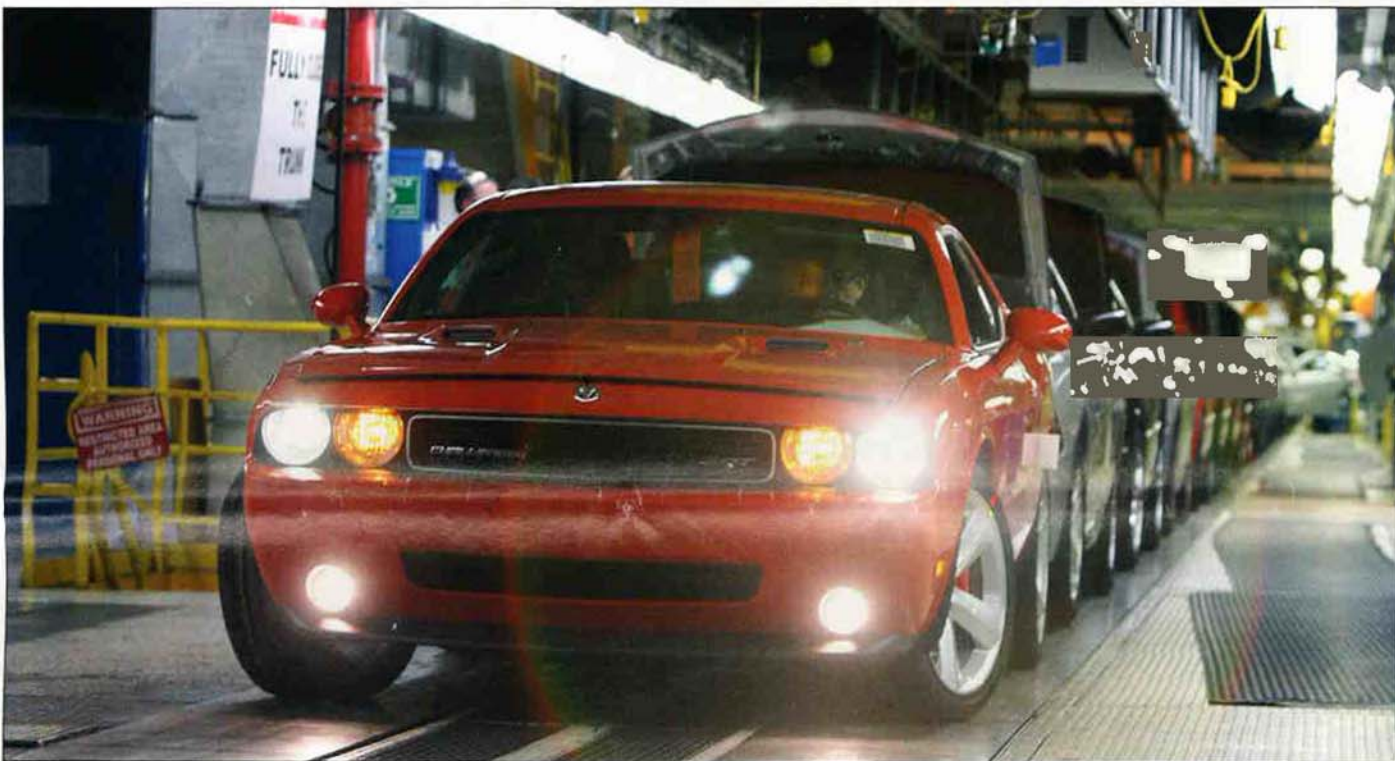
KANSAS  
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## BUYER BEWARE?

**In the wake of the restructuring of Chrysler and General Motors, will real estate investors view car dealerships and manufacturing facilities as great deals or lemons?**

Coleman Wood

The spring did not bode well for two of the once "Big Three." Chrysler filed for Chapter 11 bankruptcy protection in April, followed shortly thereafter by General Motors. Both companies are seeking to significantly trim the number of dealerships they operated as part of their restructuring plans. GM will reduce its number of dealerships by

2,641 — a decrease of more than 40 percent from its current level of 6,246. Chrysler will shed 789 dealerships, many of which will be closed by the time this magazine arrives in readers' mailboxes.

Once the parking lots are empty and the signs are taken down, what is next for these thousands of vacant car dealerships? Many of these proper-

ties are located in high-visibility areas along retail corridors. Will expanding automakers from Japan and South Korea be able to come in and find success with these old lots, or is redevelopment the best alternative?

"Car dealerships are almost easier to redevelop, because there is less of an improvement on them and less of something that someone would think was useful," says Richard Knitter, principal with Oak Brook, Illinois-based Great Realty Advisors. Most dealerships consist of a large parking lot with a small, one- or two-story building on it, so redevelopment usually just means leveling the property and starting from scratch. Knitter calls it a blank slate, in which you can develop almost anything you want.

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## A NEW DESIGN

**Architects are shaping a new model for project collaboration in order to jump-start development.**

Kevin Jeselnik

Heartland Real Estate Business recently spoke with a collection of Midwest-based architects about the changing nature of their role in commercial real estate. As financing becomes harder to secure and the construction pipeline slows, design firms are seeking to take a larger up-front role in the process to land business and push projects forward.

## DIVERSIFY THE PORTFOLIO

In order to engage with clients at the earliest possible point in a project's life, many architecture firms are working to diversify the project types they can offer, as well as engaging in the development process in new ways. Dublin, Ohio-based M+A Architects, formerly Meacham and Apel, has redoubled its focus on available government incentives, which includes being aware of, writing and submitting grants for developers, while also building relationships with city officials looking to take advantage of those opportunities.

"We have employees that focus on [incentives and grants], enabling them to start the education process for developers," says Matt Canterbury, director of business development for M+A Architects. "It is a higher level of networking, and it is one more step towards diversifying what we can offer clients. It is extremely important to continue to grow our services in a market like this."

With developers, M+A is completing more up-front work before a proj-

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## A NEW DESIGN

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ect goes forward. "It is more of a partnership attitude," says Lori Bongiorno, an associate with M+A. "We are doing more work before a project goes forward. We are trying to forge a relationship and get in on the ground level."

Additionally, the firm has broached the possibility of becoming an equity partner in projects alongside the developer. A more vested interest in a project ensures the firm's involvement, and provides a higher probability that it will move forward in this financially unstable environment.

"Generating an equity component of an architectural company is really just bridging the gap between the things we already do and the few parts of the process in which we aren't yet involved," Canterbury says. "The benefit right now, is that if the architect is being asked to help provide funding, we become more vested in the success and rewards of that project."

For Hollis + Miller Architects, which has offices in Lee's Summit, Missouri, and Overland Park, Kansas, diversification has always been a focus. According to Ed Alexander, a vice president and partner, the firm established four core areas — K-12 education, higher education, municipal and government work, and private commercial development — in order to offset real estate's natural up-and-down cycles.

"In slow economic times, we find that competition increases greatly in the municipal/government sector

amongst architectural firms, as those with core focuses in other areas try every other possible avenue — which is understandable," Alexander notes. "The part that hurts the most is not so much the competition, but when that competition starts cutting fees. If that occurs, when the economy rebounds, it is very difficult to get back to normal fees."

### FOLLOW THE MONEY

An architect's standard fees once were the only financial considerations necessary for design teams on each project. Now, firms are assuming a larger role in the financing as a way to ensure that a project has the best possible chance of moving forward.

"In order to get these projects off of the ground, we are networking with banks," says Canterbury. "We are educating ourselves about various banks and financing options, and then acting as a liaison and educating them as to why a project works and what makes it viable. It is equal parts sales, business and architecture."

Relationships are also being forged with municipal entities, as the recession and subsequent stimulus funds have necessitated the growth of public/private partnerships in commercial real estate.

"We are seeing a lot more city involvement," Alexander says. "There is an emerging push/pull relationship between some of these cities that believe they must protect the public's interest and the design team, which has the expertise regarding what the public and developer wants."

### East Hills; St. Joseph, Missouri Hollis + Miller



In St. Joseph, Missouri, Hollis + Miller has redesigned the East Hills Mall, an approximately 30-year-old, 700,000-square-foot enclosed mall, into a modern shopping center with enclosed and outdoor space. East Hills regional landmark, and the only enclosed mall in the northwest Missouri area. Owner MD Management understood the needs of the community and had the desire to improve the property and take it into the next generation of design, creating spaces that more accurately reflect what size requirements tenants are looking for, as well as some outdoor excitement with a lifestyle component and an interior that enhances the shopping and leisure experience.

This was a center built over 30 years ago and then expanded about 20 years ago. As a result of time and economic conditions, the center needed a complete makeover inside and out. In addition, Hollis + Miller created an exterior lifestyle component. East Hills is anchored by Sears, Dillard's and JC Penney.

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"That is a trend that we've really identified," Canterbury adds. "For at least the next 5 years, the private work from the past is not going to be financed or be done the way it used to be done. There is going to be significant public money, be it from a city, large retirement fund or trust agency, to drive private development."

### CONTINUING EDUCATION

In some ways, an architect's role has always in part been to educate

developers about the most practical or desirable design possibilities. Now, firms are taking the education process much further, from explaining to a bank a project's viability or informing a developer of the benefits of sustainable practices. One emerging source of business for architects is retrofitting existing properties for maximum sustainability.

"Retail owners are starting to realize the large capability for public impact

*ARCHITECTS, continued on page 22*

### The Marina District; Sandusky, Ohio

#### M+A Architects

The Marina District is a mixed-use venture that involves a series of public and private improvements to a stretch of waterfront property along the Lake Erie shoreline in Sandusky, Ohio. The proposed plans for this extensive multi-phase project include three residential buildings, a hotel development, an expanded public park area along the shoreline with increased public



access to the shoreline park, and approximately 25,000 square feet of commercial space for retail and restaurant development.

As a cooperative enterprise, the public improvements will be spearheaded by the City of Sandusky, while the private developments will be led by Alternative Development, a real estate development firm based in Columbus, Ohio.

The Marina District will incorporate a range of eco-friendly practices and sustainable building materials, providing a stylish and comfortable community that also helps to conserve the natural resources that surround it. As a master planned community, the buildings, as well as improvements to the streets, parking and public shoreline, will integrate "green" living practices wherever feasible.

Each building in the project will also be seeking to register for LEED certification. The project demonstrates several new and changing development trends, including:

- Mixed-use developments incorporating heavier residential components with smaller retail/restaurant components, whereas previously many developments trended the opposite way.
- Sustainable live, work, play developments. In general, the residential sector has been slower to adopt sustainable design trends.
- Public/private development partnerships for the purpose of economic stimulus and affordable sources of financing through the public agency.

# MURKY WATERS

*Vague laws threaten to dry up development on U.S. wetlands.*

Ashley Ball

Confusion surrounding the definition of wetlands has challenged cost-efficient development in the Midwest since the initiation of the Clean Water Act of 1972. While the Environmental Protection Agency (EPA) and the Army Corps of Engineers (Corps) have diligently enforced regulations, vague terminology has made it difficult for developers to build on various types of wetlands.

In 2001, the Supreme Court loosened the government's grip over wetlands with its decision in a case brought forward by the Solid Waste Agency of Northern Cook County (SWANCC). Essentially, the court agreed that the Corps did not have jurisdiction over certain isolated wetlands without any connection to navigable waters. Although the SWANCC decision had a significant impact, challenges associated with developing on wetlands connected to navigable waters remained intact.

Michigan developer John A. Rapanos waged a 20-plus year battle with the Federal government to seek some clarity. Unfortunately, Rapanos' campaign, which was resolved in 2006, with damages paid in 2008, simply created more ambiguity regarding wetlands and commercial real estate development.

"In the end, the two decisions did not make a lot of difference in the way that the Corps handles [permits] in our general area," explains Andy McCord, environmental manager with St. Louis-based consulting firm Midwest Testing. The ultimate outcome of the decisions was to lead to further litigation and further uncertainty on the part of environmental consultants and the Corps. It's been mutually frustrating."

According to Midwest Testing, the Rapanos decision has intensified permitting procedures, adding time to an already lengthy consulting and review process. Depending on the amount of wetlands or streams that will be impacted by a development, the Corps requires either a Nationwide Permit or an Individual Permit to begin construction. A Nationwide Permit, which is based on the standard provisions of a general permit, requires that less than half of an acre of wetlands or less than 300 feet of a stream be impacted by a project. Generally, if more than half of an acre or 300 feet will be impacted, the developer must seek an Individual Permit.

While a Nationwide Permit can be executed between 30 to 90 days after being submitted to the agencies, an Individual Permit will typically take between 9 to 12 months to be approved.

In an industry where timing is crucial, many developers are willing to make significant changes to their projects to allow them to apply for a Nationwide Permit.

Based on the Clean Water Act, the individual states are also required to address water quality conditions, which can add more time to the permitting process. In Missouri, a project is required to receive a 401 Water Quality Certification from the state before it can get underway. For a development seeking an Individual Permit, the state will review that project's 401 Certification at the same time the Corps and EPA are evaluating the project. On the other hand, for a project seeking certain Nationwide Permits, the state will typically wait until that permit is secured from the Corps before assessing its 401 certification, which can take up to an additional 60 days to be processed.

"This can be a big deal," McCord explains. "Even if only a relatively short length of a minor stream would be impacted by a commercial development, in Missouri it may take five months if you include the state's [permit process]. In Illinois, this can extend to a year or more."

In addition to timing issues, one of the most costly factors for receiving a permit deals with proper mitigation.

As part of the permit process, developers are required to replace or compensate for the amount of wetlands or streams they impact. Although the mitigation does not have to be completed in advance in order to receive a permit, developers must be able to specify exactly how they plan on replacing the acreage.

"Mitigation costs can be an issue," McCord says. "But the biggest problem in cost to the developer is time delays. [With time delays], you're not getting your development built and you could lose tenants or the whole deal."

According to McCord, many developers and consulting firms are looking to the Obama administration to find a happy medium where developments can proceed cost effectively with all the due diligence required to evaluate and mitigate their impact on the environment. Ultimately, that would require bringing some clarity to the boundaries of the Clean Water Act. In securing a standard definition of what should and should not be protected, there is hope that the permitting process will be streamlined. □

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But increased competition among sellers is not the end of the obstacles. Many of the contracts potential buyers sign are contingent on being able to get their redevelopment plans (including zoning) for the site approved. For retail redevelopment projects, you also have to factor in that a buyer will want a significant number of tenants signed on before beginning construction. Finally, there is financing to consider. Mitchell says that banks are so wary about funding a vacant development site in the current economy that an owner must be willing to put up a significant amount of cash or have considerable equity in the project. Regardless of the difficulties, Mitchell still thinks buying a dealership can be a sound investment.

"There is definitely interest [from buyers]," Mitchell says. "We've had a very enthusiastic response from developers, private investors and owner/users who understand that car dealership real estate is some of the best out there."

Its value is no longer as a car dealership, though. Auto sales are plummeting across the board, and it is rare

to see a new dealership looking for space or an existing one looking to expand. Chrysler and GM are all but permanently reducing the size of their companies and it is not likely Ford will try to expand, as it does its best to stay in the black. Japanese automakers, which have captured an increasing amount of market share in recent years, are also doing their best to stay profitable while staying competitive with each other. There is also increasing competition from the two Korean automakers, Kia and Hyundai.

"Hyundai and Kia are kind of second-tier; they have definitely made huge strides over the last 5 years, but they have a ways to go, too. They are looking to fill space, but are they going to be aggressively taking market share? I wouldn't anticipate that," Mitchell says. There has been increasing talk about Chinese and Indian automakers entering the American market in the coming years, but how long that could take and how successful they would be is up for speculation. What is certain is that the majority of these vacant sites will have to find a new use in order to secure a new lease on life.

Looking to the future, Mitchell believes that sites in stronger markets and better locations will turn over within a 2-year period. Sites in more distressed markets — especially in Western cities such as Phoenix, Albuquerque and Las Vegas, and in Midwestern cities such as Cleveland — will probably still see a fair amount of vacancy over the next 5 years. Dealerships in far suburban and exurban markets will also have a harder time finding buyers, since location will be key to redeveloping the sites.

While buying vacant auto dealerships for pennies on the dollar may seem like the next big real estate trend waiting to happen, the complications involved in redeveloping a site and the inability for many to just sit on a land parcel that is producing no income, may keep much of the speculation from occurring. For long-term investors, though, acquiring and redeveloping a 2- or 4-acre parcel can present enormous opportunities for the future. Empty parking lots are going to be a regular sight for the next few years, but patience will eventually yield new opportunities. □

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that their centers have," Canterbury says. "Developers want what they are doing to be transparent, with signage that depicts green elements, which is used to both educate visitors and attract tenants."

The challenge in the Midwest is to convince most developers of the cost benefit of going green. According to Canterbury, Costar reports show that green properties on the coasts fetch higher rental rates than standard projects, while that trend isn't seen in the Heartland.

"We see sustainability growing faster in the retail sector," Alexander adds. "But it is going to take much more education on the part of developers to understand the financial benefits, such as the cost of lease and cost common area maintenance."

In the years ahead, as the industry emerges from the downturn with a more efficient, sustainable business model, we can all hope that lessons have been learned, and that architects, developers and lenders have all been taking the same classes. □