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Developing a Difficult Property

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by Steve Bergsman

Although Russian writer Leo Tolstoy probably never developed any commercial real estate, it was good of him to lend us an oft-quoted line that is easy to revise in a way that entirely sums up opportunistic development strategies: all difficult properties are difficult in their own way.

With so many investors seeking to acquire real estate, the price of well-located commercial properties has risen sharply. As a result, smart investors have turned to such value-added strategies as acquiring troubled properties and rehabbing them for the modern world.

Not all difficult properties can be fixed. Even those that can often elude an investor's best intentions. The problem is, trouble comes in many forms—bad location, environmental complications, crumbling infrastructure, bad access, etc. It takes dedication and innovation to turn these difficult properties around.

Fortunately, it can be done, and a number of SIORs from around the country have laid out some interesting success stories about tackling troubled properties.

Move a 30,000 Gallon Tank!

Here's a question that most commercial brokers have never dealt with, and probably never will—but then again, you never know: What do you do with a 30,000-gallon propane tank? That was the problem that faced **John R. Robbins, SIOR,** of Carpenter/ Robbins Commercial Real Estate Inc. in San Ramon, California. His company had been doing work for the Clorox Corporation, which held some land in Kentucky. For 10 years, Clorox had been trying to buy a propane distribution facility, owned by AmeriGas, located in the center of Clorox's holdings in Kentucky.

AmeriGas liked its location and was simply not motivated to sell. Eventually, the propane company told Robbins that if he could find them a location that would better integrate and improve the presence of a retail outlet, it would consider moving. In the course of 10 years, Robbins worked with four different managers at AmeriGas before convincing the fifth that a site five miles down the road was the place to be.

AmeriGas moved from no to yes, but Robbins had to find a way to move the propane tank. "Have you ever tried to relocate a 30,000 gallon propane tank that not everybody wants as a neighbor?" he asks. Probably not, but if the question ever comes up—ask Robbins. First, he managed to quiet the potential neighbors and get the city and fire marshals to sign off on the new site. Then, down in Arkansas, he actually found a company that specialized in moving propane tanks. The specialist transported the tank down the highway and reinstalled it. Mission accomplished.

Creative Financing Can Be the Solution

Sometimes the hurdles with a property are not physical but financial. The town of Sauk

Village, Illinois, engaged **Michael J. Piscoran, SIOR,** of Grubb & Ellis Company in Rosemont, Illinois, to sell a 422-acre property to an industrial development company. On the surface the assignment appeared straightforward, but it was fraught with numerous infringements: defaulted positions in the financing by the previous developer and a property that was deemed on track for a deed in lieu. These elements created barriers to selling outright.

Prior to engaging Grubb & Ellis, Sauk Village was working with a development company on the site to produce a special-use rail port. The town approved numerous economic development incentives, but the developer was not able to complete the deal and Sauk Village was forced to take the property back. The town was also faced with the arduous task of refinancing the Tax Increment Finance (TIF) Bonds and structuring an alternative method that would transfer the land to another development company. "I've worked on numerous projects for municipalities," says Piscoran, "but this is the first occasion that a municipality could not sell a property outright."

Sauk Village structured a solution that included a new TIF District Bond allowing the property to transfer to a developer and using the financing to acquire and develop the infrastructure on the property. With Piscoran's assistance, the town conducted a thorough search for an alternative development company. Once the developer was engaged, a development agreement created a public/private partnership that structured a conveyance of property, investment vehicle for infrastructure, and a mutual strategic compliance of the TIF Bonds.

Choice of Developers Paramount

Problem developers come in all forms and complicate projects in an incomprehensible number of ways.

Darlene T. Marsh, General

Associate member, an attorney at Greenebaum Doll McDonald PPLC in Nashville, Tennessee, shakes her head in dismay at the muddle the original developer created with a project called King's Creek Golf Club in Spring Hill, Tennessee.

Just a few weeks before acquiring the property, developer David E. Miller learned the state had filed suit against the prior owners for multiple environmental violations.

"The project was a mess," says Marsh. "Nine holes were completed; the other nine just mud." That was only the beginning. The state charged the previous developers with failure to implement a storm water pollution plan, failure to maintain silt fencing along creek beds, and failure to obtain permits to install rock walls, construct a road crossing, and pump water from on on-site creeks to fill a pond.

David E. Miller went ahead and acquired the property, bringing in an environmental engineer and Marsh, who specialized in environmental issues. "We brought the property into compliance in spite of the previous owner's problems," she recalls.

There was one lingering headache regarding discharge of irrigation water into the on-site creeks. Through a public-private partnership among the golf course, the state, and the city of Spring Hill, however, they not only solved the problem, but actually improved the water quality of the creeks that run through the property. Says Marsh, as an extra bonus, the project won a governor's environmental award for excellence.

The King's Creek situation was fairly rare in that the original developer planned poorly and thus put the property in environmental jeopardy. More often than not, a developer has to deal with a property that is already environmentally challenged.

The Challenge—Transform Industrial Site to Luxury Residential

Fred F. Caldwell, CCIM, SIOR, with the Caldwell Watson Real Estate Group in Houston, Texas, is perhaps a glutton for punishment. His company decided to acquire a northwest Houston sand and gravel mining operation and redevelop it as a high-end residential community.

Although it is now master-planned and 70 percent complete, it wasn't easy, says Caldwell. "The front end was extremely expensive and lengthy. It took two years of planning approvals at a cost that was multiples of our original budget."

The project totaled about 400 acres and of that, 50 acres were actually mining pits as deep as 80 feet. The solution there was to decrease the depth, line the pits, and fill them with water to create lakes.

"We took something that was very much a negative and turned it into the highest-end project in the region," says Caldwell proudly.

Good Engineer—a Valuable Collaborator

When **SIOR Jeffrey A. Nickol's** Atlanta-based firm, ICore Commercial Real Estate Services, decided to buy two 1960s-era buildings near Atlanta's Hartsfield Jackson International Airport, Nickol encountered something he had never seen before—commercial buildings with septic tanks.

The 398,000 square feet of space had been on the market for leasing, but Nickol liked the location and asked the owner if he wanted to sell. Perhaps the project had not been for sale because whoever bought the facility was going to have to connect the buildings to the city's sewer lines.

The sewer connection piping had to travel 1,500 feet and pass through as many as four different properties—no easy task. A further complication was the fact that three owners refused access. "We had to design the sewer line to go around other properties and work through gravity flow instead of pumps," Nickol says.

The lesson learned here, he adds, is, get yourself a good engineer.

Street Access Plays a Part in Development

If it's not sewers, then something else—like roadways. Two SIORs saw the potential in two older properties, but in both cases it meant getting the city to approve changes in local street traffic.

F.L. Schmidt, a Danish cement company, hired **John L. Crampsie Jr, SIOR,** of Summit Management and Realty Co. in Allentown, Pennsylvania, to find a buyer for an old campus of buildings it owned in nearby Catasauqua. The property covered 17 acres and bordered the Lehigh River.

"My selling point to prospective buyers was that it could be developed in a way that would take advantage of its riverfront location," says Crampsie. "I was thinking along the lines of retail."

Crampsie found a developer who liked the retail idea but wanted to add residential elements.

Because the property had been industrial for almost a full century, there were numerous environmental issues to consider. But there were also other concerns.

"We took something that was a negative and turned it into the highest-end project in the region."

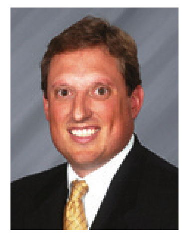
—Fred Caldwell, CCIM, SIOR

Getting the city's cooperation was complicated. For the new development to work, the property had to be rezoned and a one-way street running alongside it had to be converted into a two-way street.

Here was a property where all the old buildings had to be demolished, a lot of environmental work completed, zoning ordinances rewritten, and traffic patterns changed. How did it all come out? "An important aspect was that the initial concept presented by the developers was enthusiastically accepted by the town. Thus, although negotiations were difficult at times, they were always cushioned by the fact that everyone agreed on what was being pursued and in the end, everyone was satisfied," says Crampsie.

The city of Waterloo, Iowa, faced a similar situation. John Deere, the large agricultural machinery manufacturer, has operated a large plant in the city for almost a century. The company had reinvested more than $100 million in adjacent properties and was willing to donate their excess property to the local economic development company (EDC).

This was a big property—about two million square feet of space comprised of multiple buildings on approximately 40 acres of land. **Robert L. Smith Jr., CCIM, SIOR,** president of



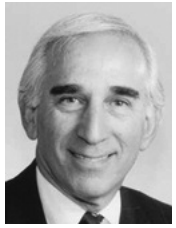
Lockard Realty in Waterloo, Iowa, was also the former president of the city's Chamber of Commerce. He had been asked to run the numbers to see if EDC should accept the buildings, since the property presented not just opportunity but also a large financial risk.

Ultimately, the EDC decided it would take the space with some help from John Deere. The plan is to use 800,000 square feet of the existing structures and, most likely, demolish the rest of the buildings. The key obstacle for the site was the property's poor accessibility. The city decided to build a new road from Highway 63 directly into the site and the remaining John Deere locations adjacent to the property. "The new street is designed and approved," says Smith. "It has really opened up people's eyes to the fact that the property is accessible and is a place where they can do business. One of the biggest hurdles was overcome. We have data centers and bio-based companies signing LOIs already"

Losing an Anchor Tenant

A good example of this is a Garland, Texas, strip center that Dallas-based The Weitzman Group was called in to help revitalize. The immediate problem was that the 92,560-square-foot center—Buckingham Plaza—lost its grocery anchor and was not likely to get another. Without a grocery anchor, the center's other stores were struggling.

"We could not turn around and lease the space to another grocery store because the space was too small," explains **Herbert D. Weitzman, SIOR,** of The



Weitzman Group. In addition, the center, built 30 years ago, was in a transitional neighborhood that at the time could be best described as moderate to low income.

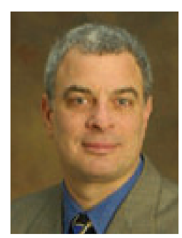
"We knew there was a cost to bringing someone else in and converting the space," says Weitzman, "and we also had to find a tenant mix that would make sense for the community."

After about a year, Weitzman finally found a smaller anchor, 99 Cents Only, and then Fallas Paredes fell in behind it as a second co-anchor. To revitalize the in-line space, Weitzman brought in traffic draws like Melrose, a popular clothing chain in Texas. In conjunction with the re-tenanting, the center was completely renovated. Today, Buckingham Plaza—which appeared to be headed for high vacancy—is 97 percent leased.

Parking an Issue

Three years ago, Podolsky Northstar Realty Partners took a chance on an older office building that was losing its main tenant. The 293,280-square-foot Concourse Office Plaza in Skokie, Illinois, was built in the mid-1970s. The outdated building was about to go from being 99 percent leased to 49 percent leased. One of its biggest problems was a tough parking situation.

"There was not a lot of surface parking, and 70 percent of the cars coming to the facility ended up in a parking structure adjacent to the building," says



Randy D. Podolsky, SIOR, an industrial specialist with the Riverwoods, Illinois-based Podolsky Northstar. "As any developer knows, the problem with multi-story parking facilities is that no one likes to park on the upper levels. The bottom floors of parking are jammed full, but the top floors are empty."

As the new owners, Podolsky Northstar embarked on a multi-million dollar make-over, and, to overcome the perceived parking problem, the company attached the second and third stories of the office building to the fourth and fifth floors of the garage. "We cut openings, created connections, installed vestibules and made proper entrances attached to common areas," says Podolsky. A new tenant leased one of the "attached" floors, and as part of the lease stipulation, employees of the firm were obligated to park on the fourth tier of the garage. An innovative and simple solution removed a perceived impediment.

It Can Be a Pricing Matter

Sometimes a solution to a troubled property is both radical and simple at the same time.

Kevin C. Geenty, SIOR, of the Geenty Group, REALTORS® in Branford, Connecticut, found himself representing an old but well-maintained distribution facility in the nearby town of Clinton. The 186,000-square-foot, 40-year-old building was owned by three attorneys and leased to Unilever, which was consolidating and subsequently vacating the facility.

Unilever had been grandfathered into the property through an acquisition but, in fact, Clinton was not a good location for distribution. "This property was off the distribution route and quite a distance from I-91 and I-84, the main roads for shipping," says Geenty. "The question was, how do you rent a distribution facility not good for anything else where no one wanted to distribute from?"

The answer was actually very simple: a radical price change. The building was put on the market, says Geenty, for $2.65 a square foot when buildings in the main distribution corridor were going for $4.50 to $4.55 a square foot. A mattress company from South Carolina decided to take the property, but here's the kicker. It only took a three-year lease, so the lease rate kicked in higher at $3.40 a square foot. Everyone, including the owners, tenant, and agent was happy with the outcome.

Challenging Properties Worth the Effort

Usually the problems with troubled properties are not external like environmental issues, road access, or a 30,000-gallon propane tank needing to be removed. Generally, the properties have simply outlived the reason for which they had been originally developed. They are no longer useful in their existing format in their current location; they have structural deficits such as small floor plates, or they are simply too old and worn out.

If the location is good, however, a little creative alchemy can turn these loadstones into gems.