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**JOE CARTER**  
SVP and Manager  
Wells Fargo

**DAVID BRAINERD**  
Managing Director

**ERIN PEART**  
SVP  
Wells Fargo

# Mixed-use: A Conversation with Wells Fargo

One of the biggest challenges for mixed-use projects is to secure financing for all of the various components. Most small, local lenders shy away from mixed-use projects and so developers must turn to larger, more established lenders for financing. To learn more about how these big lenders view mixed-use, we sat down with Joe Carter, SVP and Manager, and Erin Peart, SVP, of Wells Fargo, one of the world's leading commercial real estate lenders. David Brainerd, Managing Director of Madison Marquette also joined the discussion to share the financing perspective of an experienced mixed-use investment and development company.

**Q: What is your opinion of mixed-use development?**

**WF:** From our experience we think communities are the greatest beneficiaries of large scale mixed-use projects. We have also seen developers do well, but the margin for error is so thin because of how complex mixed-use projects are to execute. Most of these projects do not really hit their stride until five to seven years after delivery.

**DB:** Developers who understand the risks and opportunities going into a mixed-use development project have the best odds for success because they have more realistic projections upon which to base their investment decisions. Financing is a good example. Mixed-use projects are much more expensive to finance than traditional projects because most lenders require construction loans to be syndicated with several other lenders. Not only will the syndication require substantially higher legal and administrative costs, but it will also lessen the negotiating power of developers who are facing a pool of potential lenders that is much smaller today than it was a year ago.

**Q: Is there a value-added premium to mixed-use projects?**

**DB:** There certainly is a value-added premium to mixed-use projects in terms of the rents we can command for retail or office and the sales per square foot we can command for residential housing. These complementing uses are viewed as a significant amenity for everyone — although some markets are more attracted to it than others.



Bay Street, Emeryville, CA

**WF:** Often the premium associated with rental rates and residential sales is hampered by the complexities of developing and managing these projects. Developers are usually paying more for financing, taking longer to get approvals and have more trouble flipping such complex projects to long-term asset holders.

Perhaps the biggest challenge facing mixed-use developers is that each product type has its own lifecycle. When a project delivers, retail and office may be peaking, but residential could be bottoming out. In one sense, this disparity may help stabilize returns. However, in another sense it limits the upside potential substantially.

**Q: What are some of the lessons learned from recent mixed-use development?**

**WF:** From a financing perspective, we have learned that every component of a mixed-use project needs to be examined individually. Each use needs to be able to survive on its own for the project as a whole to make sense. The retail component is the most complex of these uses and it requires the most careful study.

The team is also critical. While one developer with expertise in every area is ideal, there are not many of those players in the market. When developers in different areas come together, we have found that it works best when there is one decision-maker and when investment horizons are aligned. When

goals are not shared and decisions are decentralized, it usually results in project delays that can cripple returns.

**DB:** Having good relationships with development partners is indeed critical. The ideal situation is a partnership between developers who have worked together on smaller projects before tackling a larger one. We have also seen that retail is the lynchpin for many of these mixed-use projects and that too many of them are executed without a good understanding of the retail real estate market. Retailers are fickle and they require precise standards and co-tenancies to occupy a space and be successful.

**Q: How do you view medical uses in a mixed-use project?**

**WF:** In the right location, we are comfortable with medical office. There is, however, an added complexity and cost of the construction that must be considered. Additionally, if it is too specialized there may be issues. For example, there is less flexibility in projects that have a high percentage of lab space. In those cases, we, and the developers, need to think about a design that can be converted and leased for other purposes, such as traditional office, and the cost of doing so. But generally, in a mixed-use project, aside from potential parking issues, the traffic coming from medical office appears to be beneficial to overall site.

**DB:** Medical office is a greater driver for retail and therefore adds significant value to the overall project. Much of the added construction cost can be recaptured through longer lease terms and higher rental rates. It is important, though, to partner with an experienced medical developer who understands the complexities involved.

**Q: What are your thoughts about the future of mixed-use development?**

**DB:** Mixed-use projects will continue to gain momentum because everyone involved is becoming more comfortable with them — from investors and lenders to developers and consumers. Local communities are also demanding them. High energy prices and growing metropolitan areas are making high-density development a desired necessity for many markets.

**WF:** We will continue to see mixed-use development, but the volume and pace will be dictated by how volatile the market is for each product type.

David Brainerd (david.brainerd@madison-marquette.com) is Managing Director in our Washington, D.C. office. Joe Carter (cartejl@wellsfargo.com) is SVP and Manager of Wells Fargo. Erin Peart (pearte@wellsfargo.com) is SVP of Wells Fargo. **P**

## MIXED-USE THEN & NOW

In 1976, ULI issued their seminal report, *Mixed-Use Developments: New Ways of Land Use*. This report identified the then emerging land use trend and detailed the ingredients for success, as well as provided case studies for projects that were to become landmarks.

One case study highlighted the efforts by Hines Interests to bring a new high density, integrated urban form to north Houston. This project – *The Galleria* – highlighted the complexities and rewards involved in large-scale mixed-use development.

In 2002, ULI awarded Gerald Hines the J.C. Nichols prize for visionaries in urban development. That award's honorarium established the ULI Gerald D. Hines Urban

Design Competition. The goal of the competition was to bring together teams of graduate students that represent the architecture, design, and business disciplines to tackle urban problems in a unique interdisciplinary approach and, thereby, raise the next generation's awareness of the important role high quality urban design plays in creating living environments. In 2004, a Hines endowment permanently funded the competition to cultivate future land use leaders.

The 2008 competition saw 96 teams representing 25 U.S. and Canadian universities enter for the top \$50,000-prize. Past locations and winners include:

Year	Location	Winner
2003	Washington, D.C.	Harvard
2004	Pittsburgh, PA	Arizona State
2005	Salt Lake City Valley, UT	University of Colorado
2006	St. Louis, MO	Harvard
2007	Los Angeles, CA	University of California Berkeley
2008	Dallas, TX	University of Pennsylvania

A collage of images and text for MidAmerica Prepaid. The top left features the MidAmerica Prepaid logo with 'A Division of BB&T Financial, FSB'. Below it are photos of people shopping and a woman at a computer. Text boxes include 'Cardholder Support 24/7', 'eCommerce', 'Customized', 'Secure', 'Turn-key', 'Value', 'Nationwide', and 'Solutions'. Logos for VISA and DISCOVER NETWORK are shown. At the bottom is the website 'www.MidAmericaPrepaid.com'.

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