

# OLD WALLS, NEW USES - MALL MAKEOVER: THE PATH TO A MEDICAL MECCA

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Not everyone has the eye or the interest to sell or develop adaptive reuse, but if you're passionate about it, "it's a labor of love," says Sandra Jarvis, president of IndySquared Commercial Properties in Indianapolis. One challenge, she says, is that "you have to look past the pigeons and the disrepair and paint the picture for the buyer."

So why bother with reuse when you can show straightforward steel and glass? One word: location. "The biggest advantage to adaptive reuse is that you can get a terrific location. In most cities, the best sites are pretty picked over, but you get a great site if you reuse," says Bill Adams, CCIM, CRE, president of Adams, REALTORS®, in Atlanta. Older buildings may also be protected by historic preservation ordinances, making rehab the only option.

Adaptive reuse isn't cheap, though. Bill Roberts, vice president of operations at National Louis University in Chicago, estimated that he spent an added 15 percent to 18 percent to build out classrooms and other interior spaces in six floors of a historic Daniel Burnham–designed building at 112 N. Michigan Ave. Extra costs included reinforcing floors with steel to support the library and wedging in faculty office space between the two-story X-shaped braces that the architect used to stabilize the 20-story building.

Reuse can also come with some unwanted surprises. "You never know what animals you'll find when you open the walls" in an adaptive reuse project, says Frank Micali, CCIM, managing partner of Capitalize360 Group in New Haven, Conn. Add in the expenses of zoning permits and "you don't want to buy a reuse project for more than 50 percent of eventual market value," he says.

## Picking a Reuse Candidate

Even at a good price, not every building is a good candidate for reuse. "The physical constraints of the asset are the single most limiting factor in most adaptive reuse projects," says Todd Clarke, CCIM, CEO of Cantera Consultants & Advisors Inc. in Albuquerque, N.M. Small floor plates, antiquated construction techniques, and the need to preserve historic elements all limit a building's future uses. "We recently worked on a historic Route 66 motor lodge with very small units," recounts Clarke. "Even though the market might have supported retail or rental housing, we had to focus on either senior or student housing."

Fitting a reuse project into an existing building is often like constructing a jigsaw puzzle, says Craig VonDeylen, principal of Perkins VonDeylen Architects in Indianapolis. Each of the eight residential units in the company's Fletcher Place Lofts (a former church parish hall) is a different shape. The lack of uniformity makes management and marketing more challenging but also makes the property unique, he says.

Floor loads are often issues when you're changing a building use, says Stanley Rabun, a professor in the architecture department at the University of Tennessee in Knoxville. Office buildings usually have a floor load of only 50 lbs. per square foot. Change the use to a restaurant and you'll need to double that, says Rabun, co-author of *Building Evaluation for Adaptive Reuse and Preservation* (Wiley, 2009). Rabun advises that before buying any building for reuse, do a buyer walk-through "and let the building tell you what's wrong." Many major problems are apparent even before you call in the structural engineer for due diligence, he says.

The need to bring a building from the 20th century or even the 19th century into compliance with 21st century building codes adds another hurdle to the physical aspects of reuse. For example, says Rabun, if you renovate more than 50 percent of a commercial building or spend more than 50 percent of its value on renovation, you usually need to bring the structure into compliance with the Americans with Disabilities Act.

Zoning requirements can be another barrier to reuse in downtown locations. "We actually had to contract for parking spaces in a nearby surface lot to meet local zoning when we adapted the CenterPointe condominiums, even though only about 25 percent of our residents have cars," says Michael Schaffer, managing member at C.A. White Co. Inc., which developed the 83-unit New Haven property.

Yet some cities are becoming more flexible. In 1999, Los Angeles helped set a new bar when it passed special Adaptive Reuse Zoning Incentives to encourage residential redevelopment in its downtown core. Incentives included breaks on parking requirements, lot line setbacks, and density.

## Matching the Use to the Market

While the physical limitations of a project will in part dictate a building's final use, market demand is just as critical to consider. That might seem obvious, but sometimes buyers or community stakeholders get excited about the possibilities and lose sight of the practicalities. "You'll go talk to a neighborhood group about reusing a site that could support a grocery, and they'll want you to bring in a Nordstrom," says Clarke, who's advised several local governments on reuse projects.

That's when "you have to bring it down to dollars and cents" using a market study with costs and demographics, says Clarke. In some cases, stakeholders' desire or political pressures on local government may override market data. Then you have to tell the community "to hit up the city council and get the extra public funding needed to make that use viable," Clarke adds.

## Finding Funding for Reuse

Perhaps the biggest advantage of adaptive reuse projects these days is that they're often easier to finance than new development. Federal stimulus funds slated for state governments will probably provide more money for public-private partnerships to revitalize downtowns.

"Governments are the new sources of money," says Larry Kosmont, CRE, president of Kosmont Cos. in Los Angeles. Among the public-sector sources for reuse financing are Historic Tax Credits, which will pay up to 20 percent of rehab for qualified historic structures; New Market Tax Credits, which are available for redevelopment in economically depressed areas; Recovery Zone Bonds, which can provide funding for economic development in areas of high unemployment; and Small Business Administration loans, which can be used to rehab or improve energy efficiency in commercial buildings used in part by the buyer's business.

Tapping into these funds can require a little research and a little showmanship. Sometimes there's a clear local "development itch waiting to be scratched," a hole in the planning board's agenda that you can fill, says Kosmont. Other times, developers have to be willing and able to advance funds for planning and design to prepare effective presentations that will stir the public sector's interest. "Otherwise, the project often dies in the initial review," says Kosmont.

Clearly, adaptive reuse isn't for the faint-hearted or the impatient. But if you're willing and able to tackle the challenges, it may be one of the best opportunities in commercial real estate today.

## Mall Makeover: The Path to a Medical Mecca



A 1960s-era mall in Nashville, Tenn., might not be your first thought for a sleek medical complex, and you wouldn't be alone. "The consensus in the local real estate community in the early 2000s was that the only thing to do with One Hundred Oaks Mall was tear it down," says Tony Ruggeri of ATR Associates in Dallas, one of the two partners who bought and

adapted the two-story property. But even though the mall was tired, it clearly still had a great location. With only 45 percent occupancy, the in-place retailers like PetSmart and T.J. Maxx had some of the highest sales numbers in the city.

Even before they closed on the property in Dec. 2006, Ruggeri and his partner, Frank Mihalopoulos of Corinth Properties in Dallas, had planned to rehab the 800,000 square foot mall and convert the largely vacant second floor space into offices. They started working with a commercial broker to find tenants for the space.

Enter Vanderbilt. The university-affiliated academic medical center was looking for back office space in spring 2007 and contacted the pair about leasing part of the five-story building at the back of the property, says Vanderbilt Medical Center Senior Director of Facility Resource Strategy and Management Cyril Stewart. At the same time, Stewart was also developing ideas to build a new medical office building with structured parking on the university's already crowded campus. Looking at One Hundred Oaks, he realized he had found a better option. The mall's high visibility at the junction of several expressways, the easy access, and proximity to the medical center's main campus all seemed to lead to another possibility: a medical complex.

"The One Hundred Oaks facility was much less expensive and much more convenient for our patients than building another property on our main campus," says Stewart. Traffic studies showed that most of the medical center's patients lived less than 15 minutes from One Hundred Oaks. A shuttle could link the site to the university in 15 minutes. Parking for the anticipated 1,000 daily patients to the new clinics would be convenient and free. It all seemed to fit.

The execution got a little tougher. Retailers had to sign off on changes to the permitted use clauses and site configuration limitations in their leases to allow for the medical use. Vanderbilt spent weeks negotiating an option to purchase the center to protect its \$64 million construction investment.

Fifteen months of remodeling—including building out all the extra plumbing, HVAC, and electrical a medical center requires—also had its challenges. All the work went on just above the ceiling of operating retailers. "We worked off hours and added security so retailers below felt protected," says Stewart.

While Vanderbilt worked inside, Ruggeri and Mihalopoulos rehabbed the exterior. "We took off all the concrete panels and metal and opened up the windows. Strains on the roof from installing new equipment necessitated a roof replacement. Parking was repeatedly reconfigured and signage repositioned so that in-place retailers didn't lose substantial business during the construction period."

The new Vanderbilt Health One Hundred Oaks Medical Center opened in March 2009. Energized by the transformation, in-place retailers remodeled and new restaurants came on board. "When I look now at the completed project, I don't remember the difficulties, only the tremendous results," says Ruggeri.