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The real estate industry is repurposing buildings to unlock value and find new solutions given the rising cost pressure, new standards and technology advancements, which are forcing many companies to re-evaluate their strategy and operations.

In our first article, we looked at repurposing real estate and explored examples in different real estate asset classes around the world.

In this article, we will discuss the legal issues facing repurposing projects, including through construction.

# Legal issues in repurposing real estate

Repurposing real estate is the use of real estate or buildings for a purpose other than what was originally intended. It is one of the most cost-efficient ways to maximize the value of property. However, repurposing comes with challenges, some of which may delay construction or even prevent owners or tenants from occupying the property. As it involves the change in use of a property, there are several legal issues that should be considered for repurposing projects.



## **Intended use**

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Any new uses for the property will have to comply with zoning or land-use requirements. This may sometimes be a challenge when repurposing to mixed-use, especially for properties that are built on residential areas. Changing the use may also affect utility rates – some jurisdictions may have more affordable rates for residential zones. Changing the use may also trigger payment of additional land price – some jurisdictions have different prices for different land uses and a change in land use may entitle the grantor/seller to adjust the price based on the new use. Changing the use can also trigger variation in the applicable property tax rates and/or special contributions, as some uses may have lower tax rates and/or special contributions in countries like Italy and Mexico.



## **Permitted use**

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Lessees and lessors must not violate any permitted use requirements or restrictions on construction works in the building, including but not limited to those established by condominium regulations and restrictions. Lessors of multi-tenant buildings may consider the usefulness or applicability of redevelopment rights, but they must always use care when exercising such rights. In the leasing market, with the rise of e-commerce, existing retail locations can be repurposed as flagship stores, last-mile logistics or adjusted to meet customer need, but both lessees and lessors must do so in compliance with their contractual obligations.



## **Building regulations**

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Repurposing must also meet building regulations. Renovations usually require building permits. This could include compliance with fire, safety, environment, or disability regulations. For example, repurposing in the US can trigger the Americans with Disabilities Act. Repurposing of older properties may require the replacement of regulated building materials such as asbestos, mercury or lead and/or approvals from governmental bodies that protect properties with historical value.



## Easements

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Parties should also review the title to the property to ensure any re-purposing does not breach any existing easements, or that may require the incorporation of new ones. For some buildings, there may be restrictions on shared-space arrangements. In some circumstances, major changes in the structure in use may require consent from benefitted parties.



## Land or building requirements

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From a construction perspective, compliance with the building contract remains. However, with rising uncertainty in the market, from issues relating to cost, to supply chain, digitalization, to delivery timeframes, having flexibility in contracting can be beneficial for both sides. Allowing the opportunity to pivot or change the project, if mutually beneficial, can provide common ground and protection for both sides of a deal.



## Financing

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Financing conditions and requirements may require creditor consent for any renovations or constructions. Being aware of financing arrangements and requirements is a must before carrying out a new project.



## Insurance

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It is critical to review insurance policies and vacancy clauses in existing leases in the event repurposing is happening during the term of a lease. If a tenant has moved and left an asset vacant, the insurance policy covering the property will either nullify coverage or alter its terms and conditions, effectively reducing coverage. Tenant should obtain new coverage for a repurposed property to ensure full protection.



## Sustainability

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Several companies today are trying to reduce carbon through construction during their repurposing of real estate processes, and there is a trend in shifting to more sustainable construction materials and modernizing existing structures (for example, through retrofitting) which reduces greenhouse gas emissions and creates healthier spaces. Also, the American Institute of Architects form construction documents have been updated and one of the separate exhibits that now exists is dedicated to sustainability. The documents also have a check the box in many instances where sustainability is a factor, and this may include LEED certification, use of sustainable programs and so on.

# A note on Mixed-use

With a dynamic market and unforeseen and unprecedented rates of change, repurposing to mixed-use buildings can provide owners with an opportunity to insulate their portfolios from volatility. In Germany, about half of all repurposing projects use mixed-use concepts, such as pairing retail space and restaurants or office space with residential developments.

However, in some jurisdictions, converting to mixed-use may post difficult challenges. In China, it is very difficult to design one and the same building with more than one use, although changing from one use to another use is possible after securing the necessary approvals and permits. A change in use may require the approval of homeowners' associations in residential developments and securing their consent may prove difficult. Repurposing can provide opportunities for legislators to think creatively and recognise that a change or more flexibility in use or zoning could deliver immense value to the community.

## Final words

Repurposing provides opportunities to unlock value for owners, builders, government, occupiers, and communities. We are seeing different business approaches to repurposing, but legal issues will still need to be addressed and they all differ from jurisdiction to jurisdiction. The purpose of repurposing real estate will be lost if the project is not completed or if any of the approvals or permits necessary to occupy the property is not obtained.



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