Unique Issues In Retail Leasing

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THE NEGOTIATION of a retail lease for a shopping center involves a number of issues that are unique to the retail environment. Distinctions are made between major tenants, sometimes called “majors” and smaller, inline tenants. Major tenants have substantial bargaining power and, as a result, can often successfully negotiate significant economic concessions and rights to control the operation and appearance of the shopping center. Since the success of a shopping center depends on attracting customers, landlords require retail tenants to be open and operating and accordingly include opening and operating covenants in their leases. Similarly, major tenants expect other tenants in the center to be open and operating. As a result, major tenants require landlords to agree to “co-tenancy conditions.” If certain other named co-tenants are not open and operating in the shopping center, or if a specified percentage of the leasable space in the center is not open and operating, the major tenant will negotiate lease remedies, including the right to pay a reduced rent and the right to terminate its lease. The particular use of the premises and the trade name under which a retail tenant operates are heavily negotiated in a retail lease. Exclusive use rights are often granted to major tenants in shopping centers. Exclusive use rights benefit the recipient tenant.
by limiting direct competition. However, the granting of exclusives greatly complicates leasing of a shopping center not only for the landlord, but for new tenants coming into the center. Assignment and subletting provisions are particularly important in the retail context because landlords want to control the tenants and the type and quality of the merchandise sold in the shopping center. As a result, these provisions are heavily negotiated. Landlords negotiate for limitations and control, while tenants bargain for flexibility so they can assign or sublease to a broad range of assignees or subtenants. Retail tenants often pay percentage rent, which is based upon a percentage of their gross sales; in addition to a base rent, they typically pay a share of the landlord’s operating expenses but major tenants can negotiate concessions from the landlord which reduce their obligations for reimbursement of various operating expenses. Retail tenants may also pay promotional fees and advertising charges to reimburse the landlord for its costs of advertising and promoting the shopping center.

MAJOR TENANTS VERSUS INLINE TENANTS • The relative bargaining power of the landlord and tenant is a significant factor in the negotiation of any lease. In the retail context, major tenants have the leverage to negotiate significant lease concessions which not only affect the landlord, but other tenants in the center as well. There is no single definition of a major tenant. Rather, they are often defined by the type of shopping center in which they are located. In a regional mall, a major tenant would be a department store. In a strip center, a national or regional grocery store, a big box tenant or a theater might be considered a major tenant. In a power center, which is comprised primarily of large tenants like, for example, Costco, Target, or Home Depot, with a few small inline tenants, each large tenant might be considered a major tenant.

Major tenants can successfully negotiate significant lease concessions because they are considered destination tenants and draw customers to the shopping center. Since their presence is considered a benefit to the landlord and the other smaller tenants of the shopping center, major tenants can successfully negotiate favorable lease terms, including economic concessions. Often the major tenant will not pay interior common area maintenance charges in an enclosed mall (e.g., costs to heat, light, maintain and clean the interior mall). They may pay no or a reduced share of exterior common area charges (such as the costs to maintain and clean the parking area). Major tenants may negotiate an annual cap on the common area charges that they must reimburse each year regardless of the actual costs. They may pay no or a reduced share of the landlord’s real estate taxes. They typically do not pay promotional fees or marketing charges for the center.

Majors often negotiate rights to control the appearance and operation of the shopping center. Major tenants have the right to approve changes to the common areas of the shopping center within a designated “control area.” This control area typically includes the sidewalks, driveways and parking areas in front of the major’s premises and may also include the primary entrances to and driveways of the shopping center. Majors do not want landlords to alter parking fields, access routes and the flow of traffic in proximity to the major’s premises in a manner which would be detrimental to its business or use of its premises. Majors often have the right to approve the size of the signage of other tenants, the design and color of building exteriors, and the storefronts of other tenants (including color, design and height). Majors want to ensure that the signage and storefront size and height of Inline or other non-major tenants do not exceed the size and height of the major’s signage and storefront. Majors get priority positions on shopping center pylon and monument signs. Major tenants often negotiate the right to assume responsibility for the maintenance and repair of the common area in their portion of
the shopping center, at their sole cost and expense, in lieu of reimbursing the landlord for such common area maintenance costs. If a landlord is not properly maintaining the common areas, a major may negotiate a “self-help” right to maintain and repair their portion of the shopping center. Major tenants often have the bargaining power to successfully negotiate favorable exclusive use rights and co-tenancy rights.

The lease concessions granted to major tenants have an impact on both the landlord and the other tenants in the center. If a major tenant has the right to approve changes to its “control area,” the landlord who wants to reconfigure the parking lot or re-locate driveways within the control area as a part of the redevelopment of the shopping center, will have to obtain the major’s consent. If the lease for Major A says that no other tenant may have a storefront height which exceeds the storefront height of Major A, then a new tenant coming into the center will be subject to that height restriction. While this limitation may not be a problem for a small inline tenant, a national retailer (“Major B”) which has a prototype storefront design which exceeds the Major A height limitation, may well object to that limitation. The landlord must then ask Major A to waive its height restriction as to Major B or risk losing the opportunity to sign a new lease with Major B.

The economic concessions granted to a major tenant have an economic impact on the inline tenants. If a major tenant has negotiated the right to pay a reduced share of common area charges and no real estate taxes, the inline tenants pay a disproportionate share of these costs and thereby subsidize the major tenants. The justification for the subsidy is that the majors are the primary customer draw for the center which benefits the inline tenants.

USE CLAUSES AND TRADENAMES • Trade names restrictions are heavily negotiated in retail leases. Landlords of malls in particular, strive to maintain a good mix of quality tenants and merchandise that will attract customers. Landlords also want to avoid over-competition resulting from having too many retailers with similar uses operating in the center. To achieve these goals, landlords try to negotiate in each lease a narrowly defined “permitted use” that limits what a tenant can and cannot sell in its store (e.g., “the premises shall be used for the sale of apparel and shoes for children and for no other purpose”). If the landlord wants to guarantee that there is at least one children’s apparel store in its shopping center, it will want to make sure that the use clause negotiated with the children’s apparel retailer is narrow enough that it cannot convert its use to something else. Landlord will require the tenant to operate under a specified trade name, because the trade name helps the landlord control the use of the premises and also ensure retail name recognition that draws customers. If a landlord has leased space to a nationally recognized women’s apparel retailer, the landlord does not want that retailer to convert its use to the sale of children’s wear or to change its store to a new concept under a new trade name which is not nationally recognized and will not be the same customer draw. The landlord’s rationale is that it bargained for a nationally recognized retailer and made rent and other lease concessions in order to induce that specific nationally recognized retailer to sign a lease. The landlord also wants a narrow use clause and trade name restriction in order to control the tenant’s ability to assign or sublet to a third party. In that way, the landlord maintains control over the mix of tenants and merchandise in the center, even if a lease is assigned or the premises sublet to a new retailer. The landlord’s success in negotiating a narrow use clause depends on the bargaining power of the tenant. Major tenants often insist on the right to engage in “any lawful retail use” and will not agree to a specific permitted use.
Although all tenants benefit from being in a diverse shopping center with a variety of stores selling different types of merchandise, when a tenant negotiates its own lease, its goal is to maintain flexibility to alter its use and trade name. Because the retail business is competitive and constantly changing, tenants argue that they need the flexibility to change product lines and to introduce new retail concepts. Tenants do not want to be prevented from doing so by overly restrictive use and trade name clauses. Tenants also want a broader use clause so it is easier to find a successor tenant should it be necessary to assign or sublet.

A retail tenant needs the ability to change its trade name in order to adapt to changing markets, remain competitive, and evolve its retail business. Accordingly, a tenant with a trade name restriction may negotiate the right to change its trade name to a new trade name used by that tenant in a majority of its stores in a particular geographic region. If the tenant creates a new retail concept with a new trade name and intends to convert all of its stores in a particular geographic region to that new concept, it wants the flexibility to do so.

In addition to the specific use clause that is negotiated in a retail lease, landlords can impose additional use restrictions by imposing certain “prohibited uses.” Prohibited uses are typically undesirable uses (at least in a shopping center setting) such as flea markets, adult bookstores, manufacturing operations, automotive repair facilities, bars and nightclubs. If a major tenant has successfully negotiated an “any lawful retail use” clause, these prohibited uses are often the landlord’s only way to control that major tenant’s use. Major tenants, too, often want certain uses prohibited in the shopping center and accordingly require the landlord to covenant in the major tenant lease that certain uses (in addition to the typical undesirable uses) will not be permitted anywhere in the shopping center or within a certain distance from the major tenant’s premises. The major tenant is concerned with uses in close proximity to the major’s premises that will take up too many parking spaces (“high intensity parking uses”), create excessive noise or loud music, generate excessive trash, or disrupt traffic flow through the parking lot. For that reason, major tenants often restrict the locations of restaurants, theaters, health clubs, car washes, and facilities for the sale of auto parts and car repairs. Major tenants, too, want to limit the amount of office space that can be included in a retail center, as office uses take up retail space (and parking) but may not draw shoppers to the center.

Another complexity of retail leasing, which is not found in office leasing, is the interplay between use clauses and exclusive use rights. When negotiating the use clause, both the landlord and tenant need to be aware of exclusive uses that the landlord has already granted to other tenants. If a landlord has granted an existing tenant the exclusive right to sell toys, and the landlord is negotiating a new lease with a children’s apparel retailer that sells some toys on an incidental basis, landlord needs to be sure that the new tenant’s use clause does not allow the sale of toys, which would violate the existing tenant’s toy exclusive. A new tenant negotiating a lease should require a full disclosure from the landlord of all existing exclusives so the new tenant can determine whether those existing exclusives will unduly restrict its ability to sell its customary merchandise.

**EXCLUSIVE USE RIGHTS** Major tenants often require landlords to grant them the exclusive right to sell certain merchandise or to operate their particular use in the shopping center and to agree not to lease space to another tenant for the same use (e.g., national toy retailer “Toys For All” requires the landlord to agree that “no tenant or occupant of the shopping center other than Toys For All may use in excess of 500 square feet of its premises for the sale of toys”). The rationale for an exclusive, from the major tenant’s perspective, is that it limits its direct competition in the center. Landlords grant