

TENANT TENSION

LANDLORDS TREAD CAREFULLY AS THEY TRY TO FILL VACANCIES WITH NEW USES

By Steve McLinden

CURRENT RETAIL LEASING MODELS PRESENT A VEXING CATCH-22 for many a landlord. If shopping center occupancy drops, lower rents kick in. But when an owner seeks to fill spaces with untraditional and nonretail tenants—a college, say, or a museum—the other tenants cry foul for violation of their co-tenancy lease clauses. The result is more pressure on owners to drop rents, especially if the lease language is less than airtight, observers say.

“This is the new world of leasing,” said Irwin Fayne, a partner and retail leasing specialist at the Fort Lauderdale, Fla.-based Holland & Knight law firm. “Ten years ago landlords weren’t nearly as cognizant of the broad-reaching effects of co-tenancy lease clauses. Today everything in a lease has come under the microscope.”

Frequently, the leases of many national retailers stipulate that roughly three-quarters of a shopping center and particularly the anchor space must be occupied, or the rent will be cut in half until a tenant of like size and quality is brought in. If no replacement is found within a year, the remaining tenants will be freed from the lease.

There are other troublesome areas. Lease language that restricts a center’s use to retail or “first-class” purposes can give tenants leverage to reject candidates they deem incompatible co-occupants, says Fayne. His firm keeps a tally on the lease restrictions at shopping centers it represents.

Older leases are likely to be far less specific

on co-tenancy, if not altogether silent on the matter. “In the old days, restrictions accounted for so-called obnoxious uses, such as adult stores and bars, but typically not service businesses, like offices or other nonretail,” said Mez Birdie, director of retail investment services at Maitland, Fla.-based NAI Realvest. But detailed leases that cite specific anchors or junior anchors by name or category will often result in some rent concessions, he says. “However, if the co-tenancy clause just has a simple occupancy requirement of, say, 70 percent, then it doesn’t matter if the use is service-oriented.”

Enhanced scrutiny of co-tenancy clauses is becoming commonplace among retailers. Chico’s, which dispatches regional sales managers to seek out and document potential co-tenancy violations, has said that it anticipates store savings of some \$8 million in such rent relief in 2009. Charming Shoppes says it will save about \$10 million in rent breaks this year. Ann Taylor, Gap, Quiznos, Starbucks, Williams-Sonoma and many other

national names have been busy scrutinizing co-tenancy clauses in search of rent relief or penalty-free pullouts.

Clint Fuller, president of Dallas-based Fuller Group Realty Advisors, says the industry is seeing more of the likes of bingo parlors, martial-arts gyms and even funeral homes at shopping centers. Some of these are creating co-tenancy disputes, says Fuller, who has examined about 60,000 leases as a retail consultant. In fact, he says, until faced with the current downward spiral, “few owners in their wildest imaginations thought that co-tenancy clauses could wreak so much havoc.”

The economy has created other obstacles, says Fuller. In cases where a sizable church is in a strip center, cities have begun enforcing minimum-parking regulations aggressively for restaurant and retail tenants, despite the fact that the churches typically operate only on Sunday mornings, when the other tenants least need the parking spaces. “Because cities are getting zero tax dollars from these churches and are struggling to meet their budgets, they are working against owners on this,” said Fuller. Moreover, he says, many of the upscale town centers built from 2005 to

2007 are unable to bring in below-market-rent tenants, even if they want to, because that violates lending agreements.

As landlords in big-box-anchored power centers struggle to maintain occupancy, they are making good lease deals, says Ivan Friedman, CEO of New York City-based RCS Real Estate Advisors. Tenants with leases that do not spell out co-tenancy restrictions are often going to litigation now instead of backing off, says Friedman, whose firm will do 70 million square feet of renegotiations this year. “There is a lot of money at stake.”

Beyond the call centers of yesteryear, there are assuredly some peculiar and unorthodox nonretail occupants popping up inside many a class-B or ‘C’ center these days—anything from a self-storage facility to a city hall, says Michael Wiener, who heads Excess Space Retail Services. Wiener says Excess Space, which is based on both coasts, will have assisted retailers to restructure at least 3,000 leases by year-end, versus the 500 to 1,000 the firm handles in a normal year. Leasing to an unconventional user is probably preferable to a vacancy, though, even if it does trigger rent reductions, says Wiener.

Shopping centers are seeing a lot of so-called non-complementary tenants becoming quite complementary, says Charles Wetzel, president of Buxton Co., a Fort Worth, Texas-based customer analytics consultant firm with retail, health care and municipal clients. Medical businesses bring a steady stream of people who then patronize other center tenants, he says.

Some centers opt not to sign any nonretail businesses, continuing instead to hold onto premium anchor spaces in hopes that retail will recover soon, says Birdie. That is a dubious strategy, he cautions, given the volume of bankruptcies and closures of the past few years—and the predictions for more of the same. “I don’t think we are going to go back to those go-go days,” Birdie said.

Going forward, leases are likely to reflect the new industry paradigm, as malls reflect more of a mix of uses, observers say. Tenants, meanwhile, will continue to exhaust every avenue in the quest for rent relief, says Birdie. “Sometimes, you have to determine if a retailer has valid claims or is just grasping for help,” he said. “The latter is often the case.” **SCT**
