

## Special considerations in retail leasing | Viewpoint

■ JOSEPH HEINS

I recently attended the International Council of Shopping Centers Law Conference, which is an annual gathering that draws hundreds of lawyers who all dedicate a significant portion of their practice to retail real estate law.



Joseph Heins

One takeaway (of many) from the conference was that not all leases and deals are created equal, and that retail real estate law presents unique and challenging issues that are not present in other areas.

Otherwise, if a retail lease was the same as any other deal, there would be no need for all of these practitioners to meet to discuss the many different nuances those deals present.

The basics of a retail lease are the same as any other — a tenant leases space from a landlord for a certain amount of time (term) in exchange for a certain amount of money (rent). However, digging a little deeper, we find many retail-specific items which require

special considerations. In the following paragraphs, I will provide an introduction to several of those unique concepts and give some context around how they may impact your deal.

### EXCLUSIVE USE PROVISIONS

An exclusive use provision prohibits a landlord from leasing space in a shopping center to another retailer whose use is in competition with a particular tenant. For example, a lease for a deli may state that the landlord cannot lease any other space in the shopping center to another tenant operating a deli or selling sandwiches. From a tenant perspective, this clause protects their business from being encroached upon by competitors and ensures that they will have exclusive access to the customers of the shopping center for their particular product or service. From a landlord's perspective, the preference would be to avoid giving exclusives altogether, but they may be necessary to get a deal done. However, landlords must avoid unintended consequences and

ensure that the limitations being placed on the shopping center are limited as much as possible, both in terms of area and scope. Case in point — the deli example above begs the age-old question: what is a sandwich?

### RADIUS RESTRICTIONS

Radius restrictions are the landlord-friendly flipside to exclusive use provisions. A radius restriction prohibits a tenant from opening another store within a certain distance from the leased premises. This ensures that the landlord receives the full benefit of a particular store or brand within the immediate area without the location being undercut by another nearby operation. Radius restrictions maximize the gross sales to be received by a tenant at a specific location, which has implications for percentage rent and gross sales kick-outs, as discussed below.

### PERCENTAGE RENT

Percentage rent is an additional form of rent unique to (some) retail leases that is paid on top

of traditional base rent and additional rent (i.e., common area maintenance, insurance and real estate taxes), where the tenant pays the landlord a certain percentage of its gross sales from the premises.

Often, the tenant does not have to pay percentage rent until its sales exceed a certain threshold (called a breakpoint), but after that amount is reached, both tenant and landlord share in the excess. Percentage rent is a form of risk sharing and more closely aligns the interests of the parties — namely, the landlord is agreeing to a lower guaranteed base rent, which helps the tenant get established, in exchange for a sharing in the upside if the store proves successful.

### **CO-TENANCY PROVISIONS**

Co-tenancy provisions protect retailers against the adverse effects to their business when a large number of the other tenants leave a shopping center. Retail locations thrive on traffic, and a significant decrease in customers can cause significant harm. Under an “on-going” co-tenancy provision, in the event that certain important, named tenants close, or if the vacancy rate at a shopping center falls below a certain threshold, during the lease term, the tenant has relief in the form of either reduced rent

or a right to terminate the lease, or both. In addition, an “opening” co-tenancy provision states that the tenant is not required to open for business (or begin paying rent) until certain thresholds are met. Those thresholds are typically either specific retailers opening or a certain percentage of the center being occupied.

### **GROSS SALES KICKOUTS**

Gross sales kickouts are lease provisions that allow a tenant the right to terminate a lease in the event that their sales from the leased premises do not exceed a certain predetermined threshold. Typically, these provisions provide a one-time only right and only after a certain number of years of the term have run. They can be important protections for a tenant if a store does not perform the way they expect. For landlords, it is very important to include lease language that requires a tenant to put forth a good faith effort to make a store successful — this can (and should) include an operating covenant, which requires that a tenant remain open and operating, fully stocked and staffed, for the entire term in order to maximize its sales.

As I often tell clients, for a retail or any other commercial lease, the devil is in the details. Unlike an agreement for the purchase and sale of a property, a lease

agreement lives on and governs the relationship between landlord and tenant for the full term of the lease (and beyond). Inevitably, an issue will arise, and the parties will pull the lease agreement off a shelf and closely scrutinize the language to determine their rights (and leverage). Words matter, and the rights of the parties in the future are determined during the negotiation of the lease from the very beginning.

It is imperative for both landlords and tenants in the retail sector to spend the time to think through these unique, retail-specific concepts during the lease negotiation stage and to ensure that their interests are clearly and adequately protected in the lease document going forward. Devoting that time and effort up-front will pay major dividends down the line.

*Joseph P. Heins, Special Counsel and member of Phillips Lytle's Real Estate Industry Team, has extensive experience in the retail sector. He provides counsel to landlords and tenants alike to service their real estate portfolios, including in the areas of leasing, sales, acquisitions, financing, public-private partnerships, project development and title matters. He has worked extensively with property owners, restaurants, grocery stores, retailers and franchisees. He can be reached at (716) 847-7004 or [jheins@phillipslytle.com](mailto:jheins@phillipslytle.com).*