

Nov 04 2013

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Practice Area: Retail Real Estate

The International Council of Shopping Center's annual legal conference is always an opportunity to share insight on the hottest legal issues facing lawyers involved in the retail real estate industry. This year's conference was no different. The following are a few highlights of topics receiving increased attention at this year's conference.

1. Medical Facility Tenants. No matter what your opinion is of the Affordable Care Act, it is unquestionable that the medical industry is changing and that medical services are becoming more of a deliverable. As such, medical service providers are looking for opportunities to locate their facilities closer to the population that they serve and traditional retail locations are becoming a popular location choice.

There a number of unique issues that are presented when a medical facility moves into a traditional retail location. For example, does a medical service provider represent the desired type of tenant? If not, then other tenants of the center should carefully examine and negotiate their co-tenancy clauses to ensure that medical facilities and other undesirable types of co-tenants are excluded from the co-tenancy calculations. In this manner, non-anchor tenants need to carefully look at the tenant mix of the center. From a landlord's perspective, the terms of the tenant improvement package must be carefully negotiated due to the fact that medical facility improvements tend to be more expensive and time consuming than traditional retailers.

2. Application of the "Reasonable" Standard with regard to Assignment and Subletting. Leases often give the tenant the right to assign or sublet the premises with landlord's "reasonable" consent. However, the leases often do not define "reasonable" other than to provide that landlord shall not unreasonably condition or delay its consent. While there are some factors, such as an assignee's lack of credit worthiness, that represent a clear basis for denying consent, there are many others that are not as clear. For example, is a lesser known brand a basis for denying a sublease? Is a change in use by the subtenant sufficient grounds to deny consent? What if the original tenant had the right to change its use?

3. Construction Contracts. As the economy improves, owners are busy starting new projects and retailers are refreshing their spaces. While construction contract negotiation has been limited due to the lack of new projects in recent years, construction contract issues received increased attention at this year's conference. One issue that arises early in every project and should be addressed in the contract between the owner and architect is the ownership of the plans. The owner desires ownership of the plans because it does not want to have to start over in its design if there is a termination of the architect contract. On the other hand, the architect wants to maintain the copyright in order to safeguard its creative works. Architects will often give assurances that they would never replicate the unique design features of the project; however, the owner of the project should ensure that sufficient contract language is included to protect such unique design features.

4. The Continued Popularity of "Pop-Ups". Pop-ups continue to increase in popularity with both landlords and tenants as is evidenced by their use in non-traditional ways. Pop-ups can now be found not only in retail centers and shopping malls, but also in airports, subway stations, and even on street corners. Tenants often use pop-ups to create a buzz regarding a new product line or for research on a new market. Landlords like pop-ups because it provides an opportunity to differentiate their center from others while generating revenue from an otherwise vacant space.

However, pop-ups do present some unique issues to address in a lease. For example, because the pop-ups tend to have short terms, tenants should carefully negotiate maintenance responsibilities to avoid incurring a significant expense that the landlord would have been otherwise responsible for if a long term tenant filled the space. The rent structure is also negotiable as most tenants prefer a gross rent structure, but new start-ups with uncertain sales and cash flows may prefer to only pay an increased percentage rent. If the latter rent structure is chosen, then it must be determined whether the new tenant has the systems and equipment to be able to accurately report sales. Parties to a pop-up lease must also clearly define the tenant's return policy requirements to ensure that the center's goodwill is not damaged by unhappy customers unable to return product but yet have a policy that works with tenant's standards of operation.

Even terms that usually require little lease negotiation sometimes require a different approach with pop-ups. For example, given the short terms of pop-up leases, some tenants may want to maintain flexibility with regard to the holdover provisions in case the location is successful.

5. Operating Costs. Some of the hot issues in the industry are not new but rather just issues that have come full circle or offer a new twist. The use of fixed common area maintenance charges or operating costs has increased in recent years. Fixed additional rent structures provide certainty to both landlord and tenant and eliminates the need to negotiate costs included and excluded from the charge. However, landlords have become increasingly reluctant to accept fixed additional rent without inclusion of a true-up provision at some point during the lease term. Use of true-up provisions requires the parties to negotiate the terms of the additional rent provisions which eliminates one of the benefits to using the fixed cost structure. Further, with the increasing popularity of mixed use projects, an issue that needs to be carefully addressed is the residential portion of the project's responsibility for operating costs. In these situations, use of fixed costs provisions may be beneficial.

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