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Trusted advisors: Altered reality - Rethinking retail lease clauses in the COVID era

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The United States continues to feel the impacts of shelter in place orders and governmentally-mandated closures since March. Local and regional economies are slowly reemerging. As businesses begin to resume operations, retail tenants and landlords face a stark new reality: Lease terms agreed to in pre-COVID times may no longer be applicable or even reasonable in this new setting. While the coronavirus pandemic made everyone review their leases for force majeure provisions, here are three common retail lease provisions that require review and stress testing in this COVID paradigm:

1. Use

During the initial shutdown of restaurants, many operators pivoted to a quasi-grocery store model and began selling some of the raw ingredients like flour, eggs, and butter. Hopefully, they checked their leases first; many retail leases have specific tenant use language. Usually negotiated between the brokers during the letter of intent phase, the specific use language helps the tenant spell out exactly what its intended use of the retail space will be, while also helping the landlord curate its tenant mix. For example, a lease for a bagel store may state that the leased premises may be used only for the sale of fresh or packaged bagels, bagel sandwiches, cream cheese, coffee, tea, and juice. Savvy bakers would also insist that the use clause include the phrase "or any other lawful use." Absent such a provision, the bagel shop would be limited to the sale of just those types of items and not the raw ingredients like flour. With the possibility of extended closures and long-term operational restrictions, tenants should confirm their lease use provision and either comply with those terms or seek consent from the landlord.

2. Cotenancy

Another common tenant-driven lease concept is the cotenancy clause. Certain retail tenants want assurances either that one or more specifically-named tenants will be operating or that a threshold percentage of the retail center will be leased to tenants or both. If there is a cotenancy failure, then certain remedies (e.g., reduced rent, the ability to "go dark" and close) may spring to the tenant's favor. As the coronavirus continues to impact tenant operations for far longer than what was initially thought and an increasing number of retailers are driven to bankruptcy, both landlords and tenants should check their leases for any cotenancy provisions.

3. Site plan and control areas

One element of retail leases, particularly in outdoor malls, is the concept of tenants negotiating types of control over the common areas outside of the leased premises. Conceptually, the "control area" is logical. Tenants with sufficient leverage will insist on "controlling" the sidewalks and parking areas and drive aisles in front of their stores to ensure that access to the store and visibility of the storefront and signage are not blocked. These control areas are typically marked on the site plan exhibit to the lease. Some tenants even use their leases to prevent landlords from allowing other tenants to conduct outdoor sales or other promotions in the parking areas. Those protections may no longer fit in a post-pandemic world. With many stores forced to physically close or strictly limit the number of customers who can shop inside, some retailers shifted to more of a "touchless" delivery/fulfillment center concept. Here, a consumer places an order remotely then drives to the store to have the items brought out to the designated parking area and loaded into the trunk. In this scenario, landlords would be advised to check their lease portfolio to make sure that operations like the touchless delivery queue do not violate another tenant's control area or outdoor sales restriction.

Now, tenants will rightfully claim that concepts such as cotenancy and control areas, much like the term and rent to be paid, are the result of arm's length bargaining and that they should have the benefit of the bargain. Landlords



will likely counter that that bargain was made under markedly different circumstances. If the retail sector is to recover from the impacts of the coronavirus, landlords and tenants will need to accept the new reality and reasonably cooperate on lease modifications while the tenants and landlords adapt to the new market.

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