

CHAIN STORE AGE

NEWS AND ANALYSIS FOR RETAIL EXECUTIVES

High rent, wrong use?

Onerous leases deals can have long-term repercussions

By Jason Baker

Some highly unusual tenant mixes have been popping up everywhere in the retail market over the past couple of years. Frankly, some of the non-retail uses now being welcomed into the retail lineup are so questionable that one day soon landlords may look around at their transformed shopping centers and wonder if they've made the right decisions. By signing too many onerous leases during the Great Recession and its aftermath -- perhaps because a scary debt obligation was coming due or that conspicuous vacancy needed to be filled by something -- some owners might just find that their top retail tenants are balking at lease renewals and, instead, fleeing for rival properties with more suitable co-tenants.

Consider one of the fastest-growing non-retail tenants taking over retail space these days -- emergency room clinics. Medical services are valuable and needed, of course, and have been the saviors for a number of retail centers faced with recessionary vacancies. The fact remains, however, that not long ago very few, if any, landlords would have done a deal with these aggressively expanding businesses, which are now paying premium rents for prime shopping center spaces across the country. Understand, these are not dental practices or minor-emergency clinics -- they are full-fledged ERs, replete with dedicated ambulance lanes and, in the worst-case scenarios, sick or injured patients being hauled into the center on gurneys. In one of the more remarkable examples of this phenomenon, the owner of an upscale Houston center, which faced a daunting vacancy after The Limited closed its approximately 7,000-sq.-ft. store, did a truly mystifying deal by dividing the space into two surprisingly polar uses -- an ER clinic and a hamburger joint. Today, these incongruous co-tenants sit side-by-side, raising the prospect of life-or-death dramas unfolding before the eyes of families strolling into the burger concept for a quick bite. Around Houston, this center had been noteworthy, not only because of its architectural beauty, but also because it was one of the few grocery-anchored projects with enough cachet to attract mall-quality soft goods retailers such as Gap, Express and Bath & Body

Works. It is still a bit shocking to the center's shoppers to see ambulances idling in front of this highly visible storefront.

One might wonder why any landlord would strike such a deal. In all likelihood, the initial conversations with these ER clinics were no longer than a minute or two with the landlord kindly declining the offer of this tenant to pay top-dollar rents to relieve the center of its vacancies. Eventually, though, the clinics come around with an offer that is 35 or 40 percent higher than average, and the landlord relents. Indeed, these ER clinics, which tend to be either independently owned or part of regional hospital systems, are intent upon positioning themselves for the future while they can. Like the banks a few years ago, they will pay ceiling-busting rents in order to lock up the best-possible real estate.

The same goes for many of the other non-retail uses that have started to proliferate in Houston and other markets. For example, a well-known Texas pediatric association now has some 40 locations throughout the Houston market, many in neighborhood shopping centers. While this particular tenant usually leases in professional buildings and offices, it is relocating more of its clinics into retail properties, which offer advantages like easy-access parking, great signage and close proximity to the customer base. While some non-retail uses are more tolerable than others, these pediatric clinics are legitimate traffic draws and a far cry from emergency rooms.

While the short-term payoffs involved in some of these non-retail deals can be considerable, the potential long-term repercussions on co-tenancy are clearly worrisome. Because medical tenants, in particular, sink so much money into their build-outs, they usually must sign very long-term leases in order to make the numbers work. Thus, today's decisions will reverberate for years to come. These economically lopsided deals -- high rent paid over the long term, with minimal build-out cost to the landlord—certainly

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have their upsides. But as the economy improves, how many landlords will realize with horror that a non-retail use has put them at a serious disadvantage for future retail success? If a key retail tenant can go down the street and be with Gap, Ann Taylor and Bath & Body Works, why should it stay next to an ER or other non-retail tenant? Retailers can simply relocate stores and add new restrictions to their standard lease clauses -- "no gyms, karate studios, massage parlors ... or ERs." A landlord with a 25-year lease to an undesirable tenant is stuck with that situation, and all its ripple effects, for the duration.

We all have to make tough decisions, and the right decision often can be a little scary. Today, we are seeing cash-strapped landlords take leaps of faith and invest in new facades, launch expensive marketing campaigns, hire more leasing people and take other painful steps in order to stand behind their properties over the long term. By contrast, sometimes the seemingly safe decision is the functional equivalent of hitting the panic button. And panicking is never good. The basic message here is simple enough: High rent from the wrong tenant can fundamentally alter the basic character of a center in counterproductive ways. And, it could be for much longer than the original deal intended.
