

Lawyering leases

By Steve McLinden

Much like the consumers who have learned frugality the hard way during this recession, retailers have developed a downturn-related habit they are unlikely to abandon anytime soon: the practice of “lawyering” leases — early and often. Those tenants that once routinely accepted such things as automatic renewal terms, common-area-maintenance fee assessments and nonretail neighbors now reflexively use outside firms to scour their leases for “outs” that can help them gain rent relief or control of operating expenses.

“We’re still seeing quite a bit of that kind of activity,” said GenoCoradino, managing director of corporate retail solutions for Jones Lang LaSalle. “The recession forced tenants to think that if they’re not growing sales, then they must look for more leverage in their rent, which is one of an organization’s two greatest expenses along with payroll.”

Technically, the term “lawyering” leases may be a misnomer, because most retailers use retail lease consultants now instead of lawyers. One such firm is New York City-based Excess Space Retail Services, which has negotiated or renegotiated some 10,000 leases for about 30 national retailers over the past three years, representing tens of millions of dollars. Much of that has involved “blend and extend” work, which helps tenants extend their leases at a lower rate over a multiyear period. The volume of cost-reduction lease work so far this year is as high as last year, says Michael Wiener, president and CEO of Excess Space. “But neither compares to 2009, when the sky was falling,” he said.

But the landlords are hardly giving away the farm, Wiener says. “You can’t just push for renegotiation to drive down costs,” he said. “You have to have some valid reasoning. Landlords have gotten more used to these requests and have been analyzing and negotiating more and expecting some quid pro quo.” Excess Space conducts a market study of the area to examine overall comparable-store

sales, vacancy rates and other indicators. “That way, we can go in and negotiate from an intellectual standpoint.” If stores are underperforming, landlords will now ask to see profit-and-loss statements or similar proof, and they will want something in return for such concessions as a long-term lease, says Wiener.

Some say that retailers looking for lease holes may have more problems than just high rent. “My guess is that any retailers who are deploying that strategy are doing so at locations that are either underperforming or are already dark,” said retail leasing specialist Irwin Fayne, a partner at Holland & Knight, a Fort Lauderdale, Fla.-based law firm. Some retailers persist in essentially “extorting” money from landlords by threatening to enforce lease exclusions even when those tenants that landlords seek to sign represent no competition, he says. “Fortunately, I don’t need to represent clients who do that,” he said. “I don’t roll that way.”

One client, Verizon Wireless, never went out of its way to pick holes in the leases of acquired rivals whose sites it shut because of their proximity to Verizon stores, Faynesays. “The only thing we did is negotiate a buyout price, sign a termination agreement and write a check,” Fayne said. “Never have I been asked to look for grounds to break the lease, even though I suspect those grounds existed in some of the leases.”

A landlord that fails to discharge its maintenance obligations or whose actions adversely affect a client’s operations is one thing, Fayne says. “But to go on a fishing expedition to simply find ways to shake dollars out of a lease, I’ve never been asked to do that, and frankly would decline that representation,” he said.

The brunt of the retailer effort to enforce such lease tenets as exclusions and co-tenancy and occupancy violations was done primarily in 2009–2010, at the height of the downturn, according to David Stone, founder and

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principal of Chicago-based Stone Real Estate Co. It was a push focused mainly on lifestyle centers that had given significant leverage to their primary apparel tenants, Stone says. “They had so many different kick-out and alternative rent clauses that when the centers didn’t fully lease out as envisioned or a vacancy occurred, the tenants made sure they got what they originally bargained for,” he said. Many of those leases were signed between 2005 and 2008, when few landlords or tenants thought they would ever have to actually enforce such clauses. “Everyone was operating under the false assumption that the prosperity of the times would go on forever,” Stone said.

During the worst of the recession, most landlords offered concessions and rent reductions on a short-term basis in anticipation of an economic recovery two to three years out, Stone says. Others took more-drastic measures. “For those landlords that did enter into long-term bargain leases to avoid triggering other tenant kick-outs, it will be some time until those centers can financially recover,” he said. “Hopefully, for them the overall higher occupancy will allow them to upgrade the rents for the other tenants so their projects can at least limp along until those bargain leases expire.”

The practice of pressing for comprehensive lease audits, also called CAM audits, and the aggressive use of other tactics for extracting value from leases has abated in the past two years as retail conditions have improved, says Kenneth Katz, a principal of Baker Katz, a Houston retail brokerage. “There was a period of time when [retailers] had nothing to lose by doing this, but landlords came to realize that a lot of those attempts were hollow and many of those stores were actually doing well,” said Katz. Such hollow efforts have stopped, but the substantive ones have not, he says. “That sort of activity continues with tenants that aren’t performing well,” he said. “You saw that with efforts by Blockbuster and Borders and other retailers that legitimately had problems. They were reaching out to landlords trying to make deals.”

In some top-tier trade areas, retailers are actually encountering record high rents instead of incentives, driven in part by lack of new construction. “They are getting sticker shock,” Katz said. Landlords of class-A

malls, where occupancy hovered at just above 94 percent in the second quarter, according to CoStar, no longer have to meet the full litany of lease demands from tenants, Katz says.

But elsewhere, leases are still proving to be malleable. Lease Resolutions, a California tenant consulting firm, says it obtained millions of dollars in mid-term rent reductions for national retailers and restaurant chains by analyzing rent-to-sales ratios and renegotiating leases. Under a self-funded compensation structure, the firm will reduce rent or the client will owe nothing, according to the Lease Resolutions Web site. Clients include Arco, Chase, Domino’s Pizza and Hardee’s.

Vigorous lease inspection has become a far more significant part of retailers’ operating programs today, says Paul Kinney, executive director of the National Retail Tenants Association, a not-for-profit organization for retailers and lease-administration professionals. “Quite frankly, it is smart way to do business,” said Kinney. “There are various things that have changed over the years, and we are just tickled pink that landlord and retailer can sit down and write a lease based on today’s realities. When this organization was started in 1996, retailers were not looking at their leases carefully like they are now. All along, we simply wanted to make sure both parties were upholding the letter of their leases, and lo and behold, we have been finding some dollars for retailers.”

Wiener concurs. “Why shouldn’t a lease renewal demand as much scrutiny as a new lease? There are hundreds of thousands of dollars at stake,” he said. “Just sending out a piece of paper for a renewal [at old terms] in this marketplace doesn’t make sense any more.”

Until the national employment picture improves, the retail recovery will remain slow and the lease scrutiny trend is unlikely to abate, says Wiener. “However, the lack of development has helped stabilize the market, and that will ultimately lead to tighter markets,” he said. “And as the market really starts to recover, those [lease savings] opportunities will start to wane.”

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the part of outside professionals, says Coradino. “We will see more of the same in 2012,” he said. Five-year leases that were negotiated in 2006 and signed in 2007 during better times are coming up for renewal, and tenants who did not renegotiate will find they are now paying above-market rent and will be wanting adjustments, he says.

“The window is still open for this, and I believe it will stay open, even in good times. Retail tenants are adopting this as part of their everyday practice.”
