

**CLIENT ALERT: RETAIL TENANT LEVERAGE**

*The prevailing tenor of the retail leasing landscape is one of caution, but tenants should not ignore potential opportunities, many of which, once reserved for credit tenants only, are now available to nearly everyone.*

**INTRODUCTION:**

The continued assault of the Great Recession on commercial real estate has provided ominous and spectacular headlines (e.g., DBSI, General Growth, Capmark), plenty of behind-the-scenes head scratching, and more than a few sweaty palms. There is a giant overhang of loans in need of refinance, many held by bailed out banks, mostly being paid by borrowers unable or unwilling to commit more equity to the fight. There have been significant bankruptcies of big box tenants creating big holes in centers that need to be filled. These are our times, and bleak as they may seem, there are some signs that everything is not rotten in Denmark.

Combine elevated vacancy rates, lender pressure, steady cash flow requirements and decreased demand for leased space, and you find cooperative, if not eager to deal landlords. The landscape currently confronting retail tenants is remarkable, perhaps unprecedented.

**TEN TO PONDER:**

Leverage is a good thing, especially if you know how to use it. The following is a non-exhaustive list of the pro-tenant, risk management, opportunistic provisions available in today's leasing market to tenants large and small:

- **Gross Rents** – there is a growing availability of gross rent deals (i.e., fixed common area maintenance, insurance and tax charges), which gives tenants rent certainty throughout the term of the lease. This protects against inflation and market appreciation.
- **Term Extensions** – options to extend the term of a lease at fixed rents create additional rent certainty and risk free opportunities in strong markets; and in weak markets, experience has shown that tenants have the ability to negotiate better deals.
- **Performance Based Rent Escalators** – by conditioning increases in base rent to the satisfaction of certain sales or performance benchmarks, the landlord's success is tied to yours.
- **Permissive Transfers, Change of Use & Space Flexibility Provisions** – flexibility breeds opportunity. Today's savvy tenant is securing the right to assign and sublease all or part of the leased space, and/or to change the way the leased space is used and occupied, without the need of landlord's

prior approval. Tenants should also seek unilateral options to expand or contract existing space, or to relocate to preferred space. These provisions provide insulation from market downturns and attendant control over, and upside in, the real estate and its value.

- **Self-Help and Offset Rights** – today's cost-conscious and cash strapped landlords are increasingly guilty of trimming services, which can lead to slow or non-performance of ordinary maintenance and repairs of both leased space and common areas, making a tenant's right to self help and offset an important protection.
- **Co-Tenancy Requirements** – if the tenant mix and synergy is important, make certain it is protected, and do so with the knowledge that remedies such as rent reductions and termination rights have potential leverage benefits.
- **Form of Lease** – while a lease form is something that the typical one-off tenant is unlikely to have in its back pocket, regional and national retail tenants of all classes and sizes should be demanding their form, which if nothing else, will result in greater consistency throughout a leasehold portfolio.
- **Use Protections** – whether in the form of a leasing covenant or full-fledged exclusive use, retail tenants are remiss if they forego the opportunity to keep competitors out of their backyards. The broader the exclusive, the more likely a future leverage opportunity.
- **Go Dark Rights & Tenant Termination Rights** – the right to shutter a store and later terminate a lease prospectively caps the financial risk of signing a new lease. Gross sales kick outs are back in vogue.
- **CAM Caps & Audit Rights** – a reasonable cap on the annual increase of operating costs creates pricing certainty, while audit rights fashion trust from transparency and provide safeguards from abuse.

**BOILING THE POT DRY:**

Whether by necessity (i.e., expiring leases) or opportunism, many will sign leases before stability returns. While risk is inherent to the market, and appears particularly acute at the moment, there are ways to manage, and perhaps capitalize upon that risk. Please contact Brad Krouse ([bkrouse@klehr.com](mailto:bkrouse@klehr.com)), Lee Sussman ([lsussman@klehr.com](mailto:lsussman@klehr.com)), Jeff Spann ([jspann@klehr.com](mailto:jspann@klehr.com)) or any of the real estate attorneys at Klehr Harrison Harvey Branzburg LLP to learn more.