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Seven essential lease provisions in mixed-use developments - by John Pariseault

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Developers who gain control of a property (whether through an option agreement, purchase and sale agreement, or ground lease) and who intend to develop or significantly redevelop the property are often subject to a time-limited permitting period and/or due diligence period specified in the agreement governing the transaction. Before this period expires, which would obligate the developer to close, the developer needs to ascertain availability of any needed construction financing and equity-partner investment. Obtaining these funds is usually contingent on the developer's being able to quickly come to terms and sign leases with enough credit tenants, provided that these leases don't contain provisions that could hinder the full development of the project.

Below are seven lease provisions in a development project that need to be crafted correctly.

1. Acquisition Contingency

In most large developments, the developer needs to sign certain leases before it can secure a construction loan and equity investment. However, if the leases are signed but the developer is unable to close on the acquisition of the property the developer cannot be obligated to perform under the lease. Therefore, if the developer does not yet own the property, then the developer's obligations under the lease must be made subject to actually acquiring the property. Tenants will often want this to be time-limited, which is not unreasonable. Whether the developer is obligated to reimburse tenant for costs incurred by tenant (architectural, legal, etc.) during this contingency period if the developer does elect to terminate the lease, is subject to much negotiation.

2. Permits Contingency

The developer of a mixed-use project will often have significant work to perform, both for the development itself and with respect to a particular tenant's space. This work cannot be performed until the developer obtains all applicable permits and approvals from governmental entities having jurisdiction. Accordingly, the lease must contain a contingency to allow the developer to obtain required permits and approvals, both for the project as a whole and the specific work that the developer has agreed to perform for the tenant. Again, the length of the contingency period and

whether costs incurred will be reimbursed are the subject of negotiation.

3. Delivery Requirements and Timing

Most sophisticated tenant lease forms contain a voluminous list of rent commencement conditions. Oftentimes, tenant will require landlord to cause all common areas to be complete and might require certificates of completion. However, in most development projects, the entire project will not be completed when a specific tenant's space is ready for occupancy. Accordingly, the lease should obligate landlord to complete only those portions of the common areas that landlord is capable of completing prior to delivering a leased premises to tenant.

Landlords and their counsel must also pay close attention to provisions that require the landlord to complete its work by a particular date. One must ask whether landlord will be reliant on tenant plans in order to complete landlord's work. In addition, the construction period should ideally commence after any tenant contingencies have been satisfied, so that that landlord is not expending funds at risk (i.e. while the tenant still has a termination right).

4. Exclusives

Most retail tenants will prohibit landlord from leasing other space in the development to a competitor. A retailer might also wish to prohibit other uses that do not appear to directly compete with tenant's use. The developer should avoid agreeing to a use prohibition that precludes other key tenants that will be necessary for the success of the development. Another consideration is what parts of the development are subject to the restriction. Perhaps the developer can limit restrictions on use to certain portions of the project in order to allow for flexibility in future phases.

5. Co-Tenancies

In most cases, retail and entertainment tenants do not want to end up being the only occupant of a development. Accordingly, they will attempt to link their obligation to open and/or pay rent to occupancy by other tenants in the development. Of course, if every tenant made this request, it would create an impasse. To avoid this, the lease should require Tenant to open even if many or all other units are still unoccupied. In return, the lease could provide an alternative rent until a specified number of other tenants have opened.

6. No-Builds

Most tenants will want to limit changes that the owner of a property can make to the common areas. In a development or redevelopment project in which layouts are often changing based upon market conditions and municipal approvals, landlord needs the flexibility to modify the site plan to react to these external pressures while preserving tenant protections on parking, access, and similar matters.

7. Operating Expenses

In many leases, a tenant pays its pro rata share of operating expenses incurred by landlord in operating the property. However, in a mixed use development containing a variety of uses (compared, for example, to a shopping center or an office tower), certain kinds of tenants might have greater demands on the common areas than others would. For example, retail tenants might have greater parking demands than the residential component of the project and thus should arguably pay a greater share of the snow removal and repaving costs. There are a variety of ways to handle this concept. For instance in a recent mixed-use condominium project that Hinckley Allen handled, certain parking areas that would be used primarily for retail tenants were made limited common elements of the retail condominium unit, and accordingly costs associated with those parking areas were made the responsibility of the retail tenants. Another strategy we've used is subdividing the land in a way that places separate buildings and uses on separate parcels of land. Even though the development looks and feels like one integrated development because it is tied together by a comprehensive Reciprocal Easement Agreement, the owner of each parcel (and therefore its tenants) is ultimately responsible for the maintenance of the parcel it owns.

This is just another step in a successful mixed-use development or redevelopment project. Stay tuned for further information on subdivision and condominium solutions, joint venture considerations, construction loan issues, and other topics of interest to developers as they embark upon mixed-use development projects.

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