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Considerations in the changing retail landscape - by Lisa DeFronzo

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Lisa DeFronzo, Hinckley Allen

A co-tenancy provision in a retail lease is a powerful tool for tenants that can have long lasting effects and unexpected consequences for landlords and developers. This provision conditions a tenant's obligation to remain open and operating based on other tenants in the shopping center. For example, the tenant's obligation to operate could be conditioned on other specifically named tenants or a certain minimum percentage of the shopping center's gross leaseable area that needs to be open and operating. If a tenant's co-tenancy requirements are not met, the co-tenancy provision could allow a tenant to pay reduced or alternate rent, or even terminate its lease.

Traditionally, many co-tenancy clauses would specifically name big box anchor tenants as the co-tenants that needed to be open and operating, based on the idea that those big box tenants were the "anchors" of the shopping center and a major draw of foot traffic. Today, as big boxes close and are transitioned into modern concepts like fitness, lifestyle and entertainment uses, landlords and developers need to pay close attention to co-tenancy provisions for both existing and new tenants.

Here are five key co-tenancy drafting considerations for landlords and developers when negotiating a new lease or amending an existing lease:

1. **The Co-Tenancy Requirement.** Landlords and developers can protect themselves by clearly defining and narrowing the terms of the co-tenancy provision. Many landlords and developers try to avoid tying the co-tenancy requirement to specifically named tenants, and instead will condition the co-tenancy requirement on a certain percentage of the gross leaseable area of the shopping center that needs to be open and operating. As an added protection, big box tenants can be carved out of the calculation of the gross leaseable area of the shopping center. The closing of a big box tenant alone could have a huge impact on the total gross leaseable area of the shopping center, but not necessarily decrease foot traffic to the shopping center or effect the operation of other tenants.

2. **Replacement Tenants.** If a tenant insists on specifically naming the other tenants in the shopping center that need to be open and operating, it is critical that landlords and developers include a broad definition of the nature, quality and size of a tenant that landlord or developer can replace one of the specifically named tenants with if that specifically named tenant ceases operation in the shopping center. This can protect the landlord or developer from having a list of required tenants in a co-tenancy provision that no longer exist. The definition of replacement tenant should also include the option for landlord or developer to split up the space and lease it to multiple tenants.

3. **The Co-Tenancy Failure.** The events which trigger a failure of the co-tenancy provision must also be narrow and clearly defined. The lease should require the tenant to provide landlord with notice of the co-tenancy failure and request that landlord confirm whether a co-tenancy failure has occurred. As added protection, landlords and developers should carve out specific situations where other tenants cease operating in the shopping center, but do not trigger a co-tenancy failure. These situations can include force majeure, certain time periods for construction, remodeling or inventory, or events of fire or other casualty. Landlords should also ensure that they have an adequate notice and cure period to remedy any co-tenancy failure.

4. Tenant's Remedies. If a co-tenancy failure has occurred, the typical co-tenancy provision will allow tenant to pay reduced or alternate rent, or even terminate its lease. Landlords and developers can reduce the risk of these severe consequences with careful consideration and drafting. Landlords can require tenants to prove reduced sales as a result of the co-tenancy failure before they are entitled to pay reduced or alternate rent. Even if the tenant abates its minimum rent or pays percentage rent as an alternative, landlord can still require tenant to be responsible for additional rent including operating expenses, taxes and other charges under the lease. Finally, tenants should not be entitled to pay reduced or alternate rent until the end of the term. If a tenant has the right to terminate the lease if the co-tenancy failure continues for a specified period of time, landlord should require the tenant to terminate the lease within a specified period of time. If the tenant does not terminate, it must resume paying full rent.

5. Other Tenants. If landlords or developers agree to a co-tenancy provision in the leases in the shopping center, those landlords and developers should ensure that as many tenants in the shopping center as possible are required to continuously operate. This is especially true for tenants with co-tenancy provisions, because if that tenant ceases to operate, it could trigger the co-tenancy provision of other tenants in the shopping center.

We advise that landlords and developers regularly review the co-tenancy provisions in their existing leases to confirm they are in compliance with the co-tenancy provisions, and assess whether those provisions need to be renegotiated.

Lisa DeFronzo is an attorney in Hinckley Allen's real estate group, Manchester, NH.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540