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Peer to Peer 10

**Making Lemonade Out of Lemons – Overcoming Restrictive Covenants and
Tenant Exclusives When Repurposing a Shopping Center**

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DESCRIPTION OF SESSION

The redevelopment of retail and mixed-use properties into modern projects that meet the needs of 21st century retail operators and tenants can be hampered by old exclusives and restrictive covenants burdening the land that are unfavorable or outdated, that prohibit new and desirable uses, or that just do not make sense given the intended redevelopment. Finding creative and effective workarounds can add tremendous value, and can mean the difference between project success and failure. In this session, participants will consider hypotheticals and will strategize together to come up with potential ways to address troublesome exclusives and restrictive covenants that threaten to impede a proposed redevelopment of an obsolete shopping center.

FACT PATTERN 1

Trophy Properties ("Landlord") owns a 3-level enclosed, 45-year old suburban shopping center (the "Center"). The Center consists of a single wing with nearly 50 retail spaces, and a department store anchor location at each end. A surface parking lot with 1,200 parking spaces surrounds the Center. Each anchor location includes 50,000 square feet of area on each level. One anchor location, and nearly a third of the retail spaces, have been vacant for more than five years. The anchor location at the opposite end of the Center has been leased to Bargain Value Mart, a discount grocery and department store chain, since the Center opened in 1974 pursuant to a 60-year lease. As the only remaining big box store of its kind in the area, Bargain Value Mart has continued to thrive despite the declining use of the Center.

Landlord wants to redevelop and expand the vacant anchor location as an entertainment complex, with a cinema, virtual reality arcade gaming, and an international dining concept that will attract a new generation of patrons to the Center. Specifically, Landlord desires to (a) convert the 2nd and 3rd floor levels of the existing anchor space into a single-level multi-screen movie theater, (b) convert the 1st floor level of the existing anchor space into a virtual reality gaming arcade, and (c) expand the anchor building footprint by constructing a 75,000 square foot single level addition adjacent to the exterior perimeter on three sides to accommodate 8 new high end restaurant spaces. The theater and arcade would be directly accessible from the new restaurant spaces and from the existing retail wing within the Center.

Landlord has received an offer to lease the entire theater space from "All Things Cinema", an international movie theater chain ("Cinema Tenant"). Cinema Tenant is requiring that its lease include the following permitted uses:

"a movie theater use employing such technology as the movie industry may evolve to from time to time during the Term, as extended. Cinema Tenant shall also be permitted to introduce such alternate uses as may enhance the experience of its patrons while in the theater premises, including, without limitation, a coffee shop use, a food court style use, any fast food use which Cinema Tenant deems to be appropriate, a café selling alcoholic beverages, a book store use, and/or a store selling technology used in or for the exposition or home viewing of movies."

Landlord needs this deal, but fears that such an open-ended permitted use provision would violate the exclusive-use provisions in a 40-year old lease for a struggling bookstore and coffee shop in the Center (the "Bookstore"). The Bookstore's lease provides simply as follows: "Lessor shall not enter into a lease for any retail premises within the shopping center with a tenant that will use its leased premises to sell books or coffee."

The Bookstore lease includes two carve-outs: (a) the exclusive does not apply when the competing use is "ancillary to a principal use", and (b) the exclusive does not apply to "anchor tenants or their replacements." "Ancillary use", "principal

use”, “anchor tenants”, “replacements” and “shopping center” are not defined terms in the Bookstore lease. The Bookstore Lease provides that the Bookstore shall be entitled to a 100% abatement of rent as is sole legal remedy for so long as Landlord’s violation of the Bookstore’s exclusive use rights continues. Although there are no other bookstores in the Center, nearly every fast food retailer in the Center has offered coffee for sale since 1974 without objection from Bookstore tenant.

1. As Landlord’s attorney, is there lease language you can suggest to make sure that uses other than a movie theater use would be construed as “ancillary” throughout the lease term?
2. As Landlord’s attorney, what are your best arguments that the carveout exempting “anchor tenants or their replacements” apply to the Cinema lease?
3. As attorney for the Bookstore tenant, what are your best arguments that the proposed use provision in the Cinema Tenant’s lease would violate the exclusive use terms of your client’s lease?

FACT PATTERN 2

Assume all of the facts set forth in Fact Pattern 1.

The expansion of the vacant anchor building will require the elimination of 400 surface lot parking spaces, leaving only 800 parking spaces to serve the Center. To address this parking deficiency, Landlord is considering building a 600-space, five-level parking garage next to the expanded anchor building, yielding a total of 1,400 parking spaces between the surface lot and new garage. The garage would provide convenient covered access to the new entertainment complex, but because of its location patrons of Bargain Value Mart and other retailers within the Center would be unlikely to park there. To recoup its garage construction costs, Landlord intends to charge patrons who choose to park in the new garage \$2.00/hour for parking, with the hope that patrons will be willing to pay for a shorter walk to the new theater and restaurant complex. Landlord does not intend to charge patrons to park in the remaining surface parking lot spaces in the Center.

Landlord is currently negotiating with an international restaurant group (“Restaurant Tenant”) to lease 4 of the 8 potential new restaurant locations for Greek, Italian, French and Vietnamese venues. Restaurant Tenant’s offer requires that Landlord reserve 200 parking spaces in the new garage for the exclusive use of the patrons of its 4 restaurant locations. Restaurant Tenant’s offer also would also require Landlord to institute a valet parking operation for Restaurant Tenant’s benefit, which would charge its patrons a flat fee of \$7.00 per vehicle to park while dining, with the proceeds to be shared 50/50 with Restaurant Tenant.

One week after Landlord notified Bargain Value Mart of its redevelopment plans, Landlord received a certified letter from Bargain Value Mart’s counsel objecting to (a) Landlord’s plan to charge Center patrons to park in the new garage, (b) Restaurant Tenant’s desire for 200 reserved parking spaces, and (c) the proposed valet parking system, on the basis of restrictive covenants in a recorded Operations and Easement Agreement (“OEA”) dating back to the opening of the Center in 1974. The OEA provides as follows:

“Shopping Center Owner shall provide a minimum of 1,200 parking spaces for the benefit of the anticipated retail operations in the Shopping Center.”

“Shopping Center Owner may not impose any charge with respect to use of the Shopping Center parking lot spaces, as shown on the attached plan, without the prior written consent of Bargain Value Mart, its successors and assigns.”

“Shopping Center Owner covenants not to restrict any parking lot spaces serving the anticipated retail operations in the Shopping Center, with the intention that all such spaces shall be equally available to all patrons during opening hours.”

1. As Landlord’s attorney, what are your best arguments to persuade Bargain Value Mart’s counsel that charging Center patrons to park in the new garage, reserving 200 parking spaces for the Restaurant Tenant, and implementing a valet parking system does not violate the restrictive covenants in the OEA?
2. Despite your best efforts, Bargain Value Mart refuses to come around to your way of thinking. As Landlord’s counsel, propose alternatives to Restaurant Tenant’s offer that could address their interest in having reserved parking and a paid valet parking operation for its patrons.
3. Are there any other development or project-structuring work-arounds worth exploring to help your Landlord client realize his vision for the entertainment complex?

