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**Workshop 2**

**Experiential Retail: Can It Continue to Grow and Will It Help Save the Mall?**

Presented to

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## Introduction

Shopping center developments involving experiential uses are growing in popularity around the United States. As consumers increasingly turn to e-commerce as their source of shopping, experiential uses are one way to attract shoppers to get off their computers, out of their homes, and into shopping centers! However, these developments which include experiential uses as well as uses other than retail, i.e., residential and/or office uses, pose unique and varied legal considerations that drafters should keep in mind as they prepare and negotiate commercial leases.

Experiential Retail – what does it mean?

Types of Uses that are considered “Experiential”

Online-First Companies (e.g., Amazon): Online-first companies, like Amazon, are beginning to appear in shopping centers across the United States. These stores are focused on increasing consumer convenience by among other things eliminating lines and check outs. This type of store caters to consumers who enjoy the experience of physically shopping but hate the hassle of long check-out lines. One prime example is the Amazon Go concept which is premised on the use and reliance of technology, robots, and automation. Such innovative concepts add to the consumer experience and drive consumers to the store and to the shopping center. Drafters will want to consider the unique business model of an online-first company when drafting the lease with an online-first tenant including paying particular attention to hours of operation and the merchandise being sold. Existing use restrictions in the shopping center should be carefully reviewed to make sure that certain merchandise isn't prohibited (e.g., the sale of second hand goods)

Entertainment Uses (e.g., Bowling Alleys and Movie Theaters): Entertainment use tenants are different than your typical retail tenant. Tenants like bowling alleys (e.g., Main Event), movie theaters, specialty entertainment (e.g., TopGolf), and, the latest craze, axe throwing, will typically sell food and have robust alcohol sales – which can often cause headaches for property managers. Special considerations need to be made for lighting, noise, and security during lease negotiations with such prospective entertainment tenants. In addition, given the size occupied by entertainment use tenants, landlords will need to focus on the impact of parking, potential increased CAM charges and security costs.

Adapted Traditional Uses (Retailers offering cooking lessons, yoga classes, etc.): In addition to both online-first and entertainment use tenants, tenants with adapted traditional uses are becoming more prevalent. Stores like Williams Sonoma and Lululemon are traditionally known for the sale of cooking ware and women's athletic clothes, respectively. However, as the trend for more experience-based shopping rises, these stores have adapted to provide consumers an experience in addition to traditional shopping. Williams Sonoma now offers cooking classes multiple times a month, where shoppers get to cook food using Williams Sonoma products. In addition, Lululemon offers yoga classes to yogis within their stores. These adapted traditional uses offer excellent advertising and marketing of the stores' products, as well as bring additional foot traffic to the stores, making it more likely that a consumer will leave with one of their products!

#### Issues created by Experiential Users

Co-Tenancy: Tenants typically want to ensure a mall or shopping center remains primarily retail with recognized and established tenants so that there is a sufficient mass of retailers to draw customers to the center. However, with the ever changing landscape of retail and the dwindling number of large retailers, retail landlords will need their tenants to become more flexible with respect to the co-tenants and uses allowed in the mall and/or shopping center. Considering that the goal of co-tenancy provisions is to ensure that there are sufficient customers coming to the shopping center/mall, entertainment uses such as mentioned above can be a great way of drawing customers to the project. From a landlord/developer's perspective, replacement tenant language that restricts the tenants to being traditional retailers has a significant negative impact on the developer's ability to re-tenant or redevelop anchor boxes. From a drafting perspective, counsel for developers and landlords will want to make sure that any replacement tenant language is drafted in a broader fashion to allow for some of the non-traditional uses described herein. This way, landlords will have the ability they need to replace an existing anchor or in-line tenant with another use which draws customers to the center while leaving a more modern co-tenancy provision for the tenant's benefit.

Use Restrictions: Traditional mall leases and existing reciprocal easement agreements almost always contain prohibited use restrictions and, by and large, these prohibited uses restrict the landlord from leasing space in the mall for entertainment uses or other experiential uses. Often, the reason for such restrictions was based on the theory that, if it's not retail, it will not help our business. However, as the entire retail real estate industry changes, so too does the desire to restrict such entertainment uses. Therefore, landlord's counsel will need to try and build in as much flexibility as possible when drafting new leases with restrictive use restriction provisions to try and keep the landlord's options in leasing vacant space as broad as possible. The parties, for instance, might

consider whether the following uses benefit remaining traditional retail tenants in a center: fitness, entertainment, office, residential, hotel.

**Parking:** Speaking of parking and parking ratios, the thinking towards required parking spaces is also slowly transforming to adapt to modern trends, much like the trend of increased entertainment use tenants in shopping centers. Tenants near an entertainment tenant will certainly continue to have specific parking concerns as entertainment tenants typically do require large parking areas. The entertainment use patrons will often take up valuable parking spaces for two hours or longer, but those same patrons are, more and more, visiting other stores within the mall following such entertainment. Nevertheless, traditional retail tenants will continue to want to include parking provisions in their leases that require certain minimum parking ratios and protected parking areas, to avoid the entertainment tenant's patrons from monopolizing the shopping center's parking in the spaces closest to their premises. On the flip side, with a rise in ridesharing companies, like Uber and Lyft, many argue that minimum parking ratios are not as large of a concern. Instead, landlords, who have entertainment tenants, should consider concepts like drop off and pick up locations for Uber and Lyft during lease negotiations.

**Common Area Maintenance Charges – bifurcation of costs amongst different uses:** Tenants at a mixed use development will likely negotiate their allocated operating expenses to ensure that they are paying a fair amount based on their size and activities. When there are diverse tenants at a shopping center, this concern is particularly heightened because traditional tenants want to make sure they are not paying higher CAM costs that are incurred from a large entertainment tenant. As a result, tenants should try and negotiate either (A) CAM caps for the first lease year and/or subsequent years, or (B) a fixed CAM provision in their leases.

#### Rights of Existing Tenants

**Waiver letters for prohibited uses:** If broad use restrictions are already in place, then landlords will need to work with the parties possessing restrictive rights to procure waivers from such parties for such restrictions. As mentioned above, a usual reason for prohibiting non-retail uses related to a concern that non-traditional retail uses would not help the tenant's business, while the emerging trend is that non-traditional uses may well be a benefit not a detriment to the traditional retail tenant. Another reason prohibited uses often included experiential uses (like bowling alleys, movie theaters, etc.) was because of the strain on the number of parking spaces created by these uses and their patrons who, pursuant to the old school thinking, would not shop after visiting such bowling alley or theater. Nevertheless, such thinking is slowly beginning to change as tenants continue to

realize that any use which draws more customers to a project is better overall, even if such use is not a traditional retailer.

## Complete Redevelopment of Existing Mall vs. Partial Redevelopment

### Complete Redevelopment

Termination of existing tenants: If a landlord thinks redevelopment might occur in the future, the landlord's attorney should keep that in mind during lease negotiations. The landlord will want to include a provision in the lease that gives the landlord the right to terminate an existing lease so that redevelopment or substantial development can take place. For most tenants, however, such a provision is dangerous because, without limitations, the tenant may be required to close their business and lose out on future earning potential and the value of past leasehold improvements made to the property. A tenant's lawyer will want to restrict the landlord's right to terminate and assure the tenant involved will be entitled to advance notice of any redevelopment plans. A sophisticated tenant may even require a landlord to pay for relocation costs, including moving expenses and broker fees.

Timing of demolition and redevelopment: Keeping in mind the notice requirements for tenants at a shopping center, landlords with redevelopment in mind have to strategically create a timeline for demolition and redevelopment. Once a developer has determined it wants to redevelop a property, the developer will need to convince local governments that such a redevelopment is beneficial to the surrounding community and then obtain permits. A developer will want to create a timeline that is aggressive enough to keep costs down and minimize loss of revenue due to a lack of tenants, but also accounts for potential delays in the development process.

### Partial Redevelopment

Construction Issues arising from demolition of vacant boxes only: If a landlord decides to redevelop only a portion of a shopping center or a mall, there are decidedly certain construction issues that arise, especially when the demolition consists of vacant boxes. If the center has other occupied spaces, then a landlord will want to consider the rights of those tenants such as "no build" areas and access and visibility rights when redeveloping the vacant boxes. Additionally, developers will need to consider permitting and zoning requirements. If part of construction becomes delayed, then landlords may face unhappy existing tenants and further expenses.

Protection of rights of existing tenants: A landlord will want to make sure that the construction does not interfere with the existing tenants' right of quiet enjoyment and right to use their leased space. Landlords should consider

noise, ingress and egress into the parking lot and driving lanes, the location of the redevelopment, tenants' termination rights, etc. A landlord will want to keep disruption of regular shopping and tenant activities to a minimum.

### Dealing with Vacancies

Replacement of Boxes with non-traditional tenants or new uses (e.g., office or residential): Vacancies are a concern for any commercial landlord because this means less foot traffic, no income from a tenant, and an overall decrease in the value of the center. Property owners of commercial space are getting creative with how they replace box and anchor tenants in their centers. In addition to considering experiential tenants, landlords are looking to office and residential uses as alternative ways to fill vacancies. Office and residential tenants can turn into successful long-term clients. In addition, having diverse tenants may lead to increased foot traffic and create a successful and valuable shopping center. However, office and residential tenants pose additional legal consideration. First, office and residential tenants will require parking for long periods during the day time. Other retail tenants probably will not want these office tenants to impact potential shoppers' parking. In addition to parking concerns, drafters will want to consider CAM cost allocations among the diverse tenants, existing prohibited uses, and noise concerns when drafting commercial leases that involve centers with office, retail, and residential tenants.

Conclusion: Experiential tenants are particularly attractive tenants to include in a mixed-use development because they increase foot traffic and boost shopping. However, leasing to experiential tenants involves unique legal considerations. Experiential tenants may have uses that clash with existing tenant's prohibited uses. These tenants also may cause parking concerns that need to be addressed during lease negotiations.

On the development side, property owners are turning to complete and partial redevelopments in an effort to protect and increase the value of their shopping centers and malls. Both kinds of redevelopments have their advantages and disadvantages, and each have their own legal concerns. Landlords have to figure out what they plan to do with the existing tenants at their centers, whether that be terminate the leases, relocate them, or plan a partial redevelopment project so that existing tenants can continue to operate during construction. If it chooses to partially redevelop a center, a commercial landlord will need to ensure that the remainder of the center remains usable and shopping disruptions are kept to a minimum.

Landlords are also getting more creative with how they handle tenant vacancies. Property owners are looking outside of retail, and turning to office and residential tenants in an effort to keep income flowing and avoiding empty spaces in their centers. However, diversifying the tenant mix will require additional legal considerations to be made during lease negotiations.

In conclusion, shopping centers are adapting to trends in commercial real estate. Mixed-use developments, redevelopments, and diverse tenancies are just several examples of such adaptations. However, as the real estate market transforms, these transformations pose new legal considerations that arise during commercial leasing.