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Workshop 14

Avoiding the Tragedy of the Commons – Best Practices for New Uses in Common Areas

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I. INTRODUCTION

II. COMMON AREAS

"Common Areas" in retail real estate will vary depending upon circumstances. Traditional examples of common areas may include loading docks, interior hallways and rest room facilities. As retail real estate evolves from historic models, however, developers are considering how best to make use of "excess" land that tenants, and sometimes the public, view as "common."

In classic economic terms, the phrase, "the tragedy of the commons" refers to the degradation of an otherwise open resource that occurs when users exploit the asset without regard to formal rules or structures, acting only in their self-interest. While developers and owners generally consider areas outside of a retail structure to be "theirs" to do with as they please, tenants and the public may have a different view. "My customers always parked there," "That's the driveway we prefer to use," "You can't build something there," "That's not an appropriate use here" are all common objections thrown up by "users" of exterior common areas when developers and owners attempt to develop, or sometimes, redevelop, parking areas or vacant land around a retail facility.

The focus of this workshop will be to consider the rules and structures that developers and owners must navigate, or sometimes create, to successful manage changing exterior common areas to other uses. Those rules and structures are sometimes "internal" or "private" – reciprocal easement agreements (REA's), use covenants and the like – but often involve more public ones such as zoning or other land use regulations. We hope this discussion will provide a framework for counsel to use when working with clients seeking to redevelop or repurpose the "sea of asphalt" or other exterior common areas at retail facilities.

III. OWNERSHIP STRUCTURE

Many common area development projects include new construction outside of the walls of the existing retail facility. If the new construction involves new retail or restaurant buildings, then the "out parcel" model where the owner/developer either sells or ground leases the tract may be appropriate. In those circumstances, REA's or covenants may suffice to establish the working relationship between the parties.

The situation becomes more complex though if the new project is for a “mixed use” – the addition of residential, office or sometimes educational facilities to the retail property. Unlike the traditional “out parcel” transaction, the end users of the mixed use may have operational concerns or potential liabilities that differ from those of the owner of the retail property. Importantly too, counsel needs to remember how the components of the mixed-use project will be financed or assessed for real estate tax purposes.

Simply conveying the land on which the residential or office building will be erected begs many questions – who is paying for the upkeep of the “common” driveway or entrance; how will landscaping be maintained; are there development standards that need to be respected, etc. Counsel should consider whether taking advantage of “common interest” legislation might provide appropriate structures or rules to manage the mixed-use project. Most states have adopted some form of “common interest” legislation whether state specific or along the lines of widely adopted statutes such as the Uniform Condominium Act, Uniform Common Ownership Interest Act or Uniform Planned Community Act.

Obviously close attention must be paid to each state’s particular requirements, but common interest legislation provides a good framework for allocating responsibilities (and costs) for open space, landscaping or other improvements. Typically, “common interest” legislation will provide direction on establishing a “unit owners’ association.” Counsel will need to balance statutory requirements for electing members of the governing body (board) of the unit owners’ association with the developer’s desire to maintain “control.” In the same vein, counsel will need to work through the methodology for assessments, and which elements of the project are covered by those assessments.

Most “common interest” legislation will require recording both a “declaration” (the document establishing the common regime and setting out voting rights, assessment methodology and similar items) and a plat or plan. Depending upon the state, those plats and plans are not necessarily subject to subdivision or similar controls, but usually only if the area subject to the common interest regime was previously subdivided from the larger tract.

Even where a common interest regime may not be appropriate for the overall development, counsel may want to remember the concept for development within a single tract. For example, a parcel carved out of a larger retail piece by subdivision might be the ideal site for developer controlled structured parking garage that serves as a “podium” for multi-family residential units. The developer may want to retain control of the garage to assure itself of adequate parking for the remaining retail properties, but either for operational or other reasons may not want to own or manage the residential units. Because it would allow for separate ownership and financing of the garage and residential components, a two-unit condominium would in that instance provides a good legal framework for the project.

IV. GOVERNMENTAL AND PUBLIC POLICY ISSUES

Most (re)developments of common areas concern parking fields. These “seas of asphalt” for better, or now mostly worse, exist for a variety of reasons but more often than not, their size is driven by local zoning controls establishing “parking ratios” based on the area or size of various uses within the retail complex. More often than not, these ratios were established decades ago and may not reflect current use or traffic patterns.

An additional but often overlooked issue when considering (re)development of parking fields is how those areas are used to determine the overall “density” or amount of development permitted on the property. Many local land use controls contain floor area ratios (FAR) or lot coverage requirements that might limit or restrict the amount of “new” construction that can occur within a parking field.

In analyzing these issues, counsel will likely want to start by gaining a thorough understanding of the history of approvals for the original development. For example, while the calculations under the current zoning code might indicate that parking for the project must be at a 4.5 spaces per 1,000 square feet of building area ratio, the original approvals might have permitted development at a ratio of 4.0 spaces per 1,000 square feet of building area. Establishing that may require investigations at the local zoning office, obtaining original, stamped “approved” plans or the like. Assuming though that even with the new development the 4.0 per 1,000 square feet of building area can be maintained, then the developer likely has a strong argument that the current requirements are inapplicable (naturally keeping to that 4:1000 ratio will drive the size of the new project).

Assuming though that such a history based “work around” of current requirements is not possible, then counsel for the developer faces a hard choice – choose the “path of least resistance” and work within the confines of the current zoning code or pursue variances or special exceptions. The latter alternatives will turn on state law but almost universally the concept of a “variance” requires establishing an unnecessary or unreasonable hardship and special exceptions require compliance with specified criteria. Those legal elements give opponents or objectors grounds to

contest the application before the local zoning board, and more crucially from the developer's perspective, open the possibility of appeals and delays.

If the developer will live with an extended project timeline, then working with the local municipality on a zone change – either a change in zoning classification for the property or a so-called "text" amendment – may be an attractive alternative. Particularly if the site is recognized as "critical," whether because of location, size or current condition, many municipalities will work with the developer to craft zoning amendments that facilitate (re)development. In effect, and ideally, the zoning amendment is crafted around the proposed (re)development, not the other way around. Because this approach usually allows for only one bite at the apple, counsel and the developer will need to be certain of the full parameters of the (re)development program. These discussions and negotiations with the municipality are best started with the zoning officer or planning director and making those officials an ally is often a critical first step.

While a certain amount of "local politics" is to be expected, counsel may have to caution the developer regarding overt overtures or communications with elected officials as those could implicate state ethics or "sunshine" statutes. Counsel and the developer should also remember that building support for zoning amendments may require neighborhood meetings or other efforts to rally support or head off opposition. Depending upon the size of the project, and the developer's pocketbook, bringing on to the team a local public relations consultant or "lobbyist" can be a significant asset.

For existing retail projects in need of (re)development, counsel for the developer may want to craft arguments supporting a zone change that take advantage of current social goals or concerns. For example, "this (re)development allows us to improve storm water management controls," or "with this (re)development we will be able to address the community's needs for more rental housing," or "we now have an opportunity to add offices to our mix and those office users will help stabilize our retail tenants" are the type of considerations that help sell the municipality on the necessity for the zone change.

The developer and its counsel will also need to remember that issues beyond the local level may need to be addressed. Highway departments, sanitary or other public utility providers and similar agencies above the municipal level might all have a say in the (re)development process. Typically, those agencies are more insulated from the political process than the local municipality so coordination with the developer's engineers and planning consultants is critical.

For a good overview of various strategies used by developers in different areas of the country seeking to (re)develop retail properties, see "Reclaiming the Strip Mall" an on-line study published by the Congress of the New Urbanism at - https://www.cnu.org/sites/default/files/MAPC-CNU%20Strip%20Mall%20Case%20Studies.pdf).

V. "TEMPORARY" USES

Owners of retail properties will sometimes try to "monetize" parking fields or other vacant land around a retail building through temporary or "pop-up" uses. These uses, and their impact on parking and other common areas create unique issues often not easily, or even logically treated by either private REA type controls or public ordinances or statutes.

First, temporary or "pop-up" uses, as those names imply, are often designed to be short term in nature. They are sometime used to simply provide an opportunity to test a new product or to see if a retail concept works in a particular location. Counsel may have to be creative in determining whether permits or licenses are needed, or whether those can be ignored on a "better to ask forgiveness than permission" theory. The developer and counsel will also need to consider liability and other issues that might arise from crowd control (or lack thereof), noise from temporary entertainment venues, and traffic flow around the location of the temporary or "pop-up" use.

Food trucks in particular raise unique or novel concerns. Does the local health department regulate food trucks? What sort of sanitary or water hook-ups are required? Does locating the food truck close to the building adversely affect fire lanes or other municipal safety requirements? Will the municipality allow or accommodate a temporary reduction in parking during the hours the food truck is operating? Last, but by no means least, and depending upon the food truck, will local or state alcoholic beverage laws permit open containers throughout the property or must a designated area be established for consuming beer or wine?

VI. REAL ESTATE TAXES; SPECIAL ASSESSMENT DISTRICTS

Construction of new buildings on land used for parking will almost certainly lead to an increase in assessed value and a consequent increase in the real estate tax burden on the project. How any individual developer or project addresses this issue turns not only on local assessment law and practice but also the ownership structure for the project. If "out parcels" are sold – either as subdivided lots or "units" in a condominium or other common interest regime – then the new tax burden will be borne by the owners of those parcels or units. The question becomes more complicated though if the developer/owner retains ownership of the land. In such instances counsel may need to work with the local assessment agency to establish separate valuations and (importantly) billing procedures to be sure that the tax burden falls on the occupant/tenant of the parcel. Failing that, counsel must rely on established lease or covenant provisions regarding allocation and billing for real estate taxes.

New valuations, however, need not necessarily be thought of as a negative. Assuming both the political will and appropriate statutory scheme are in place, an increase in property tax valuation may allow for creative financing opportunities for necessary "public" improvements needed to ensure the success of the project. Classic examples include special "Tax Increment Financing" (TIF) or tax abatement districts.

While the specific details will vary from state to state, most TIF legislation requires a determination that a specific area needs "redevelopment," that redeveloping that area will generate additional tax revenue, so therefore some (or all) of the incremental increase in tax value should be used to off-set the cost of improvements such as traffic improvements, new sewer systems or environmental improvements. Those improvements are then paid for through some combination of private financing and public (tax free) bonds, with the pay down and retirement of the public bonds coming from the increased tax revenues. (For an example of TIF legislation, see Pennsylvania's Tax Increment Financing Act, 53 P.S. §6930.1, et seq.)

In contrast to TIFs, where increased tax revenues are used to directly pay for the cost of necessary improvements, tax abatement programs typically work by "incentivizing" improvements with reduced assessments. For example, under Pennsylvania's Local Economic Revitalization Tax Assistance Law, 72 P.S. §4722, et seq. (LERTA) once the local government determines that an area constitutes "deteriorated property" then new "improvements" within that area may be eligible to have their value abated from real estate taxation on a sliding scale over a specified period of time (in PA, no longer than10 years). Under an abatement scheme such as LERTA, the property owner remains responsible for paying real estate taxes on the "original" value of the property; what is abated is the increase in value from new construction or renovations.

An alternative to using regular real estate tax assessments and funds for enhancements of a project is sometimes found with "special assessment" areas. These areas are usually described with acronyms such as "NIDs" (neighborhood improvement district) or BIDs (business improvement district). Typically, establishment of these districts involves approval by or agreement with all or substantially all the property owners in the designated area. An association is formed that manages collection and expenditure of any special assessments levied in the district. Usually, funds generated by the special assessments are used to off-set the cost of what may be considered amenities (e.g., parks, landscaped areas, etc.) but depending upon the particular statutory scheme infrastructure such as stormwater facilities might also benefit from the special assessments. While in concept close to the common area maintenance charges sometimes passed through to owners under REAs or covenants, one benefit of a NID or BID is that usually the special assessments are given lien priorities akin to regular real estate taxes. (For an example of NID legislation, see Pennsylvania's Neighborhood Improvement District Act, 73 P.S. §831, et seq.)

As with zoning changes, establishing a TIF, abatement program or special assessment area requires the developer/owner and counsel to be prepared for substantial public engagement, lobbying and similar political activities. Those efforts will take time, and counsel will need to realistically appraise whether (particular at the local level) there is an appetite for the controversy these programs almost always generate before starting down any of those roads.

VII. REAs

Classically, developers of multi-tenant retail projects, especially those involving multiple buildings (out parcels) or larger indoor malls called on counsel to craft restrictive easement agreements (REAs) or covenants establishing private controls over common areas. REAs ordinarily dealt with a laundry list of issues – where buildings might be located ("no build" areas), parking requirements and who could park where, signage rights, building restrictions on height or area (view corridors) and use restrictions to name a few. Again, traditionally, REAs were drafted with the assumption that "the shopping center" would always remain one and often, for understandable reasons, little thought or attention was paid to the possibility of non-retail uses sharing space in the shopping center. The issues and

challenges such “traditional” REAs pose when the developer/owner is seeking to repurpose/(re)develop common areas such as parking fields are legion.

Addressing issues with existing REAs most often starts with determining when consent from a tenant or third-party owner to a change is needed. Typically, changes to a site plan or permitted building areas, and revising use restrictions create the most challenges to obtaining those consents. While most retail tenants now appreciate that the retail world has changed dramatically over the past ten to fifteen years, they may still need to be convinced that the long term viability of a “brick and mortar” store will depend upon creating office or residential components within a retail project.

Equally challenging from the developer/owner’s perspective will be gaining tenant buy-in to changes in the uses that are prohibited in the project. For example, many REAs exclude from the category of a “first-class shopping center” breweries or establishments selling illegal drugs or drug paraphernalia. Counsel will need to consider such REA provisions in the context of newer popular uses such as micro-breweries or where the retail sale of marijuana is permitted.

With respect to parking, a common difficulty in many “traditional” REAs was seceding some measure of control and direction over common areas such as parking fields to particular tenants or owners. While obviously important and often a subject of difficult negotiations, it may be wise for developer’s counsel to consider how extensive “exclusive control” areas must be and whether they are important in all cases. For example, in *Levin Props, L.P v. Nouvelle Assoc., LLC*, No. A-1281-07T3 N.J Super. Unpub. LEXIS 877 (N.J. Super. Ct. App. Div. Apr. 2, 2009) the court rejected arguments that redevelopment of a shopping center was impermissible because it violated the terms of covenants supposedly restricting other businesses from making use of parking spaces in front of a particular store. In doing so, the court made much of the fact that customers of the store in question parked throughout the entire parking field, and that the store therefore benefitted from a “common scheme” for parking.

Whether in crafting amendments or revisions to existing REAs or entirely new ones, counsel for the developer will need both imagination and ingenuity (and a fair amount of luck). Looking ahead for example, developer’s counsel will need to pay particular attention to how changes in automobile usage and type will affect the use and value of parking areas. For example, will designating spaces for charging electric vehicles raise issues regarding parking space counts or violate generic covenants that parking areas will always be available for general use? If autonomous vehicle use develops as predicted, it may sense from a land planning perspective to designate large parts of parking areas for storage of driverless vehicles. If so though, how will tenants react when cars without customers occupy significant parts of parking fields? A very good discussion of this coming issue can be found in “Autonomous Vehicles and Parking: Preparing for a Bumpy Road Ahead” by Andrew Palmieri, Steven Dube and Brandon Brauer in the March/April 2021 edition of the American Bar Association Real Property Section’s Probate and Property magazine.

VIII. LEASING CONSIDERATIONS

Common area considerations can also arise in the context of commercial leases and the interplay among various shopping center tenants in and around the development. Larger, “anchor” tenants with substantial bargaining power often push for, and ultimately obtain, a great deal of flexibility when it comes to the common areas, whereas smaller tenants may be limited in the rights they have in and to the common areas. It is important that the center’s leasing documents are generally consistent across the different tenants so that competing and ambiguous rights are not arising and creating legal issues, both for the sake of landlord and tenants.

In reviewing and analyzing a shopping center’s leases as to common area rights, it is important to review the entire document, but focus on some key clauses that may contain or infer the scope of the various tenants’ respective rights in and to the common areas:

A. Definition of Demised Premises and Common Areas

A key place to focus is how a commercial lease defines the premises exclusively granted to its tenant, and the clause dealing with rights to the common areas. Usually, leases contain language specifying the rights the tenant may have to the common areas as a whole, and sometimes leases contain provisions granting exclusive or specific rights to certain portions of the common areas. The provisions dealing with the tenant’s payment of its share of common area expenses are also instructive. If the lease demises the building and a portion of land (i.e., a ground lease), the common areas would generally be the tenant’s to manage, subject to any reciprocal easement agreement or declaration of covenants that may exist.

An example of a clause restricting a tenant's common area rights follows:

"Landlord shall at all times have the sole and exclusive control, management and direction of the Common Areas including, without limitation, the right at any time and from time to time (i) to allow the sale and/or display of merchandise and/or services, (ii) to permit advertising displays, educational displays and promotional entertainment including special events, (iii) to provide amenities to the Shopping Center, (iv) to make reasonable changes to the Common Areas, (v) to exclude and restrain any person from use or occupancy thereof, (vi) to use all or any portion of the Common Areas to make repairs, improvements, alterations or changes, and (vii) to the extent necessary in the opinion of Landlord, to close all or any portion of the Common Areas to prevent a dedication thereof or the accrual of any rights to any person or to the public therein, and Landlord's exercise of such rights shall in no way constitute an actual or constructive eviction of Tenant from the Premises, result in or give rise to any abatement in or offset against any Rent reserved hereunder, or entitle Tenant to any compensation or damages from Landlord. As provided above, the rights of Tenant in and to the Common Areas are subject to the rights of others to use the same in common with Tenant."

B. Ancillary Uses

Clauses pertaining to ancillary uses that a tenant may have in connection with its primary use are another area to focus on, as these clauses often contain clues to whether and to what extent the tenant has rights to the common areas. May a tenant install trash compactors or dumpsters or loading docks outside its premises? If so, where may that occur and how might it be restricted by the lease language?

C. Repairs and Maintenance / Assumption of Responsibility

Often, if ambiguity or other silence on common area rights exists in a lease (which is not likely in modern leases, but could arise in historical documents), the repairs and maintenance provision may lend some inferences as to which party is responsible for, and likely controls, which areas of the shopping center. Does a tenant have responsibility for maintaining or otherwise repairing parking lots, landscaping, light bulbs in the parking field, or other "common" elements? Does the lease allocate responsibility for any claims for injuries to persons or property sustained as a result of the tenant's use of sidewalks or common areas?

D. Sidewalk Sales

Though landlords generally (and with some exception) do not encourage sidewalk sales, many commercial tenants desire the right to make sales from the sidewalk areas or other immediately adjacent areas. Many anchor tenants are granted these rights (i.e., grocery stores selling holiday décor or flowers from the sidewalks in front of their shops), and others are not permitted to use any area outside of their premises. Does the lease expressly prohibit the tenant from making any sidewalk sales or otherwise using the sidewalk as part of the tenant's business?

E. Permitted Uses

Often, the permitted use provision will specifically grant rights to use ancillary or other common elements, and specify parameters of such use. One example of this is a specific grant of rights to use a certain portion of the parking lot for "to go" or parcel pickup orders for the tenant's customers to have convenient rights to park or otherwise be encouraged to quickly pick up orders. Often, the rules and regulations governing the shopping center are buried in an exhibit, but these may also assist in the identification of the parties' respective rights and obligations to common areas.

F. Prohibitions on Use / Restrictions on Use

Sometimes the restricted use or prohibited use clauses are instructive in this regard. Does the lease contain any prohibitions on use besides the typical shopping center noxious uses? Are there parameters or other specific areas to review, such as employee parking areas? Certain tenants with leverage may obtain from landlord a "no-build" area where landlord is restricted from improving certain portions of the common areas in order to protect the visibility and access of a tenant's store.

Landlord may from time to time designate a particular parking area or areas to be used by its tenants and their employees. Upon Landlord's written request, Tenant shall furnish Landlord with license plate numbers assigned to Tenant's vehicles and vehicles of Tenant's employees. If Tenant or any of its employees fail to park their vehicle in any such designated parking areas, Landlord, in its sole discretion, may give Tenant notice of such violation and, if the violation is not corrected within two (2) days after said notice is given, Tenant shall pay to Landlord an amount equal to Ten Dollars ($10.00) per day for each violating vehicle calculated from and including the day on which notice was given, to and including the day when all violations by Tenant and its employees cease. In addition, Tenant hereby authorizes Landlord to tow all violating vehicles belonging to Tenant or its employees, or to attach violation notices to such vehicles, or to do both. In no event, however, shall Landlord be required to enforce any parking obligation stated herein.

G. Cart Corrals / Parking Lot Installations

Are tenants allowed to install shopping cart corrals in the parking field? If so, are the locations of such installations to be specified by landlord, or at tenant's discretion? Is tenant allowed to install wayfinding signage or other signage indicating the location of any pickup areas or parking spaces to be used for "to go" orders? One item that many shopping centers are considering, if not already accomplished, is the addition of car charging stations for electric vehicles. To the extent that a tenant desires to add charging stations for the benefit of its customers, does the lease allow such flexibility or would the tenant need the landlord's prior approval?

H. Summary

Counsel should obviously review the entire lease document, and if representing a landlord should understand the overall leasing regime at the shopping center relative to all the tenant spaces. If faced with an analysis of common area rights and responsibilities, which many of us today are (especially since the COVID-19 pandemic, which increased the desire of many business owners to expand beyond the confines of indoor buildings), these provisions specified above ought to be instructive in analyzing one's client's rights.