Wednesday, October 23, 2024
3:30 PM – 4:30 PM

Seminar 4

Experiential Real Estate: From Transactions to Transformations

Presented to

2024 ICSC+U.S. LAW
JW Marriott Orlando Grande Lakes, Orlando, Florida
October 23-25, 2024

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This session will cover a discussion of developer/landlord and tenant concerns around experiential real estate beginning with site selection and continuing through due diligence/pre-development, construction and operations.

PHASE I: SITE SELECTION CONSIDERATIONS FOR EXPERIENTIAL PROJECTS

Developer Considerations:

A commercial developer investigating the conception of a new commercial mixed-use project within a specific area of land should engage competent legal counsel and experts to research and investigate at least the following factors in considering whether to proceed with the new or redevelopment project at a proposed site:

Highway/street/Public Transportation Access. Identify public transportation and private automobile or other vehicle accessways available or planned to accommodate the construction traffic and increased patron traffic. The developer should anticipate (and include a line item within any financial analysis regarding the viability of proceeding with the project) what upgrades to existing traffic infrastructure may or will be required for the site plan approval by the local jurisdiction. Additionally, participation in public transportation management programs may be required by the local jurisdiction to approve the project. Consider the costs and feasibility of upgrading current traffic patterns to account for access for the new development project.

Zoning/Legislative Changes Needed for the Uses. Large scale mixed-use projects frequently require zoning changes or other legislative approvals. Experiential uses may increase this likelihood. For example, if the proposed project includes a large sporting arena or live music venue, it is likely that zoning changes will be necessary, which may require legislative approval. Local land use counsel should be consulted to determine allowable uses. Depending on local jurisdictional requirements, the developer may need to determine the viability of an experiential use such as an arena or large event use and whether the intended uses need to be reconsidered.

Demographics. The demographic makeup of the area in the immediate vicinity of the proposed project and the radius area your project would draw patronage from will contribute towards the type of redevelopment the developer is planning. The types of uses to bring into the project will depend upon whether there are mostly young professionals, new families, existing long-term families, and other groupings, what the average household income is for the area, whether the area is an entertainment desert or whether there is other demand for entertainment and experiential offerings. Local community plans for new multi-family housing, schools or other community amenities should be researched to determine if those projects signify a projected shift in the demographics or not.

Public Private Partnership Agreements/Economic Opportunity Plans with Municipalities. The local municipality, county or state's goals for growth, density, and planning may offer opportunities for a public/private partnership in the project, including offering the availability of Tax Increment Financing (TIF) Programs, Payment in Lieu of Taxes (PILOT) Programs and other fee sharing (or sales tax reimbursement) programs. In addition, Federal, State and Local Grants may be available to assist the development for set-side areas for green space, including walking trails, adding bicycle lanes or other recreational areas such as a basketball court area or park.

Private vs. Public Property Issues. When considering public/private partnership programs, the developer should also consider the issues that arise from blurring the lines of private property ownership with public access areas, like non-discriminatory access 24/7, protesting within public areas vs. private property, security for the businesses within the developer's private property and the liabilities of offering public access areas immediately adjacent to private property where alcoholic beverages may or may not be consumed.

Costs and Financing (proforma and investment returns). An in-depth financial analysis and research must be completed prior to moving forward with a mixed-use project. Also, the local construction costs and availability of labor in the area should be researched and summarized with respect to the overall project and the various special-needs cost and construction aspects of including experiential uses into the project.

Will you be creating joint ventures (JVs) to assist with your financing for your specialty sections like residential, office, sporting venue or retail? If so, there are a multitude of factors when bringing a partner into a new project and the plans for the completion and operation thereof.

Signage. Securing the rights to digital signage may provide additional revenue for the project through third party marketing efforts. Will the local jurisdiction require the completion of a comprehensive sign plan as a condition of the site plan approval?

Synergistic Uses and Purposes. Facing the prospect of an experiential concept, the developer must consider the uses that complement each other to obtain a successful highly sought after project. For instance, would a large format health club be complementary to an outdoor concert venue with various food and beverage options adjoining and concert attendee area? Would a digital entertainment format be complementary to a large grocery market? Would a modern bowling concept also attract the same customers as a movie theater?

Operator Considerations: Before considering signing up as an initial occupant of a new, unproven mixed-use project, Tenants must consider many factors. The following discusses some of the factors:

Hours of operation permitted by code. Depending on the zoning in the immediate vicinity of the project, or even if a multi-family concept is included in your development, what are your most beneficial operating hours? Do you need the right to operate until 2 am, or even longer?

Zoning/CUP considerations. Does the current zoning permit assembly uses? Is there a current limitation on the number of customers or guests permitted? Does your particular use require you to apply for a Conditional Use Permit (CUP)?

Noise and Odor Considerations. Will your use cause extraneous noises or vibrations that may bother adjoining occupants or neighbors? Does your business generate excessive or unpleasant odors to those within the immediate vicinity? How do you plan to handle those concerns operationally or in your business licensing with the local jurisdiction?

Liquor License issues (sip 'n stroll licenses, common consumption licenses, individual licenses). Consider whether or not your business would benefit from operating within the more common liquor licensing structure the developer is creating, or if you would be better off operating with your own, individual license. Factors to consider include serving issues (serving from special cups for common consumption areas vs. your own glasses for non-strolling drinkers), controlling where the drinks are traveling, liability for violations of serving laws. Verify with a local liquor licensing attorney, and with your risk management group for special liquor liability insurance risks and the various options available in the jurisdiction where the project is proposed.

Special Construction Considerations. Are the special materials or raw goods required for your special build-out needs available in this area? Is sufficient trained labor available in this market to complete your construction in a timely manner? Are there 'green' considerations in the local code that require you to use materials you are not familiar with in your construction? Will you need more time than typical to incorporate the 'green' requirements?

Co-Occupant Commitments. An occupant may want to ensure that certain other uses (or even named businesses) are fully committed to be a part of the project. Do you need to know a certain complementary use is committed to the project and has similar timing requirements for opening that you have? If so, at what point do you need to negotiate to drop out if the complementary use is not yet committed?

Are you only concerned about the retail or just the residential portion of the project being completed, and a certain percentage occupied, before you are required to open for business? Or, are you a lone wolf and know that if you build it, the crowds will come? Are you trying to beat another competitor to the market and just want to build here as soon as possible and let the rest of the project follow?

Timing – Milestones. What milestones does the developer need to meet for you to commence work and proceed with your construction and opening? What are the consequences for failure to meet the necessary milestones?

In selecting a site for a new (or renovated) mixed-use development, many factors will be considered for both developers and occupants. It is by no means an undertaking for the faint-hearted. Next, we will discuss some of the due diligence and pre-development factors to consider once a site has been identified to proceed with a new (or renovated) mixed-use development.

PHASE 2: PRE-DEVELOPMENT AND DUE DILIGENCE

OUTDOOR GATHERING PLACES, COMMON CONSUMPTION AND GENERALLY MAKING A "THERE" THERE.

Developer Considerations:

Developers looking to build an experiential mixed-use project need to consider and work through many factors during the planning and pre-development phases of the project. Important considerations include:

Project-Specific CCRs and OEAs. While the developer may have a blank slate in creating new CCRs and OEAs, these documents need to be carefully crafted taking into account anticipated tenant mix and uses for the project, parking needs/plan (including EV charging and valet), and plans for activation of the common areas, among other things. Developers will also want to consider how to build in sufficient flexibility and control that the project rules and uses can be adapted over time as project needs change.

Common Consumption and Liquor Licensing. Common consumption areas are becoming increasingly popular in mixed-use projects. They involve dedicated project areas where customers can bring alcohol from one

business into a common area (whether outdoor or indoor) or into other premises where alcohol isn't served. Imagine family members sipping alcoholic beverages from different establishments while enjoying a summer concert or shopping for cards/clothes/souvenirs. Regulation of common consumption areas (where allowed) varies from state to state and city to city, but all programs typically carry elements of shared risk amongst participating bars/restaurants, retailer participation, specialized security requirements, use of governance boards, and elements of participant coordination. If a developer intends to provide a common consumption area in a mixed-use project, the developer should vet all of the local requirements for common consumption early and carefully as tenant mix/location, lease provisions, and project design and construction all support the allowance of and participation in the common consumption area.

Common Area Activation. Common area activation with festivals, wine/beer tastings, farmers/holiday markets, concerts, arts and crafts, dance lessons, exercise classes, street performances, holiday photo booths, and other activations drive traffic to projects but also come with their own set of risks. In designing a mixed-use project with heavy common area activation, landlords should consider instituting programmatic rules governing use of the common areas for events and also appropriate forms of contracting including independent contractor, artist, and license agreements that clearly identify each party's responsibility with respect to the subject activation, risk allocation/indemnification, and insurance requirements.

Risk Mitigation. Some of the things that draw the most crowds and make a project into a place where people want to spend time also bring inherent risks to the project owners. Examples include fire pits, water features/play fountains, ponds, climbing walls and playground equipment. In crafting experiential projects, landlords and developers need to understand their risk tolerance (and insurance program) and how to balance appropriate risk mitigation efforts with having an amazing place. For example:

- Should the property owner put plastic rings around fire pits to prevent a small child or inebriated individual from accidentally putting a hand in it? There are aesthetic and functional trade-offs to that type of precaution. Is it really needed? How likely is the risk and at what point does responsibility for appropriate care and caution shift to the property owner?
- How many "at your own risk" type signs do you need? Do they actually do anything for you from a risk mitigation or liability standpoint?
- Should customers sign waivers before attending certain types of events or classes? Is it the property owner's or host's responsibility to obtain those waivers?

Occupant Considerations:

Occupant considerations in deciding whether to lease in an experiential focused mixed-use project are different than developer/owner considerations. Tenants should be thinking about things like: What are the costs of being a part of the project?

- How do CAMs and rents compare to established projects?
- Are there Public Improvement Fees, Retail/Sales Service Fees or other fees that affect the total bill to my customers? If there are: (i) are they inconsequential to consumer decision-making, (ii) if consequential, does the experience of visiting the project justify them, or (iii) are they so high that customers elect to buy similar products or services across town.
- Are there any unusual administrative burdens associated with operating in the project?
- Does the activation of the common areas drive traffic to my particular business or do associated noises and crowds interfere with my business operations?
- Will the operations of the experiential use unreasonably interfere with other tenants or neighboring property owners?
- What is the value to me of being in a vibrant, high traffic mixed use project?
- Does the parking arrangement fit my needs, e.g. will my tenants walk to my storefront from a parking garage or remote lot? Will they pay for close-in parking? How do I keep customers from using needed spaces while they shop elsewhere?

Tenants with experiential based offerings themselves should consider things like:

- Does the project allow my use? Are there CCRs or OEAs that would prohibit it? Do other tenant exclusives put me at risk of not being able to pursue potential expansion plans? Is my use likely to disturb other tenants to the point that I have issues with my landlord?
- Can I utilize the common areas for programs and events that I want to hold?
- Will my customers be allowed to test my products in the common areas?

- Does the Landlord control the common areas if they are owned/controlled by special districts, associations or municipalities. If not, what does that mean for my business?

REDEVELOPMENT CONSIDERATIONS

All of these considerations are heightened in the case of the redevelopment of an existing mall or strip center. Developers, tenants and other property owners need to take into account, and in many cases amend, existing leases and OEAs in connection with a redevelopment project. While landlords traditionally build flexibility for a certain amount of redevelopment and change into their leases, anchor tenants (and other major tenants) often have provisions that: (i) protect against changes to common areas, visibility, and access routes, (ii) provide for co-tenancy requirements tied to specific tenants, gross leased area ("GLA"), particular uses, and/or other metrics, and (iii) prohibit or give approval rights over certain uses or activities in the common areas. Similarly, many centers have operating and easement agreements ("OEA") amongst multiple property owners with similar constraints. Redevelopment projects frequently require a combination of temporary or permanent changes contrary to these rights.

Without a blank slate, the need for partnership between the developer and new and existing tenants is heightened, as the developer typically needs cooperation from at least some of the tenants and/or other property owners to accomplish the redevelopment. While all stakeholders may align on a shared vision of what a completed redevelopment project might look like and understand the anticipated value creation for all stakeholders, each party has different considerations that they will be focused on in negotiations. Tenant concerns are primarily focused on loss of revenue during periods of redevelopment that may come with temporary construction noise, changes to visibility, tenant closures, and/or changed access and parking. Developer concerns are primarily focused around creating a re-imagined project that is both beneficial to the community/stakeholders and financially viable.

In evaluating whether an existing center is suitable for a redevelopment project, the developer needs to closely consider all of the existing restrictions to understand whether there is an achievable path to redevelopment, which in many cases will require a combination of OEA amendments, lease amendments, and lease buy-outs. As redevelopment project progresses into pre-development, the focus changes into negotiations with key stakeholders to achieve long-term "win-win" for all.

PHASE 3: DESIGN AND CONSTRUCTION CONSIDERATIONS

During the design and construction phases of the project Developers/Landlords (collectively, "Landlords") looking to build an experiential mixed-use project or fill existing spaces in their development with experiential uses need to consider and work through many factors. Important considerations during the design and construction phases include the following:

Tenant Allowance/Landlord Work:

Experiential retail businesses often contain unique and potentially challenging build out considerations for existing, and even new, buildings. Since experiential users typically do not have simple vanilla shell or white box needs, experiential tenants will may potentially be looking for a unique delivery condition from Landlord, which may require Landlord's to use different vendors than usual, push Landlord's beyond their typical comfort zone and may make Landlords opt out of the Landlord work and push more work onto the Tenant with increased tenant allowance amounts due to the shift in responsibilities. It is important for lawyers to remind our clients of these considerations as they are structuring the economic portions of the deal and in consideration of the schedule of the project as the buildout for some experiential concepts may take considerably longer than a typical retail tenant. In the event of new construction, the Landlord and experiential tenant may elect to engage the same general contractor for the Landlord work and for the tenant build out, respectively. In this scenario, the Landlord and tenant can realize material economies of scale with respect to cost and schedule. Often the tenant can commence its portion of the work prior to substantial completion of the Landlord work; however, this adds complexity to the preparation of the construction agreements.

Unique Alterations/Improvements and Turnover Conditions:

Tenants may be looking for alterations to an existing space that (i) pose structural challenges, like swimming pools, spas, increased floor load capacities, and more open concept designs that may require creative column layouts, (ii) are bold and unconventional from a design perspective, including color choices, IT/AV installations, etc., and (iii) require upsizing of utility capacities, amongst other things. These are important considerations for both Landlords and Tenants—both economically and with respect to the physical plant. Landlords should be considering what this means for the building after this specific tenant vacates and what impacts these specific features may have on any existing tenants. Tenants should be considering if the space, if existing, can be adapted to fit the

specific needs of the Tenant's design. Many experiential retailers have distinctive (and potentially burdensome) trade dress, interior requirements, and signage (discussed further below).

As lawyers, we need to make sure our landlord clients are protected from getting too far over their skis in design and construction of an experiential concept when considering what work they will be responsible for as the Landlord. We need to consider when representing either side whether there are restrictions in development governing documents (i.e. REAs, Declarations, etc.) that restrict design and architectural freedom. As Tenant lawyers, we need to ensure that our clients have are resisting Landlord attempts to have the end of term turnover condition too onerous on Tenant (i.e. bring these spaces back to white box condition versus broom clean).

Noise and Vibration Attenuation:

Many experiential retailers produce more sound and vibration in their operations than a traditional retailer. This can pose challenges for both Landlords and Tenants. Many local municipalities have sound and vibration codes and lawyers need to advise their clients on both sides of any such codes to help inform their design and construction to mitigate transference of sound and vibration to adjacencies and keep them below these code driven thresholds. In addition to code compliance, Landlords and Tenants should ensure that they are designing and constructing spaces to reduce the impact of sound and vibration on other tenants to lower the risk of having to deal with nuisance and quiet enjoyment complaints.

Signage:

Often experiential retailers have unique signage needs. Lawyers should review signage criteria from the development, if any, and design guidelines to ensure that the specific signage is permitted or if permission needs to be obtained and from whom. Additional time may need to be built into the schedule to allow for obtaining waivers from existing tenants or permissions from an architectural review committee.

PHASE IV: PROPERTY OPERATIONS – EXPERIENTIAL REAL ESTATE

Property operations can make the difference between a thriving retail or mixed-use center and a center that struggles with vacancy and landlord/tenant disputes. The foundation for effective property operations and effective tenant operations is built on the form of lease signed by the landlord and tenant. A landlord must have oversight and control of the retail or mixed-use center to control day-to-day operations and long-term value creation, and the tenant must have the freedom to operate its experiential use without interference from the landlord or other tenants.

Property Operations – Landlord and Tenant Considerations

Permitted Uses and Restricted Uses - Negotiating with an experiential tenant often requires a hard look at the use, and often requires negotiation with existing tenants. Even as brick and mortar retail continues to pivot away from traditional retailers, often prohibitions on uses remain in existing tenant leases or CC&Rs that expressly prohibit uses that are necessary for experiential tenant operations. Uses that historically were considered to be noxious, have become desirable and necessary to driving customer traffic to the center. Examples are liquor sales separate from a sit-down restaurant use and high users of parking such as fitness centers.

Shopping Center Rules and Regulations. Well prepared leases will require tenants to observe and comply with shopping center rules and regulations and will grant to the landlord broad rights to make modifications and additions to the shopping center rules and regulations. Often, experiential tenants will push back on rules that restrict hours of operation, music, temporary advertisements/signage, limitations on parking, and remodeling/renovations.

Maintenance Obligations. Typically, landlord and tenant maintenance obligations are well defined in a lease; however, experiential tenants can often require unusual and unique branding elements that are non-standard. Such elements can be very costly to maintain and can become an eyesore if not operational. For example, a tenant might desire to use digital signage to attract its customers and might be willing to make a material investment in initial improvements. The lease should address maintenance, repair, replacement of such elements, as well as grant landlord self-help rights.

Operating Expenses. A landlord's form of lease should always reflect actual property accounting practices for charging its tenants for the costs associated with running and maintaining the shopping center (taxes, insurance, operating expenses). And while it is best practice to have a uniform process reflected in each lease, often large anchor tenants and experiential tenants have separate expense pools or specified exclusions that may not be granted to smaller tenants in the same shopping center.

Rights to Relocate. Landlords often require rights to relocate tenants in the shopping center, at the landlord's cost and discretion. Landlords view control of the center as key to maximizing value. Often an experiential tenant will occupy such a large space in the shopping center and have such a unique build-out that the landlord will be willing to surrender its rights to relocate; but for smaller tenants, these rights can be very problematic. Often a certain space is selected by the tenant for properties unique to that space (access, visibility, proximity to drivers of customer traffic) and a relocation attempt can quickly lead to a dispute over whether the new premises is equivalent. Further some experiential tenants have costly trade equipment that would need to be relocated rather than be replaced. Causing the tenant to "go-dark" during the relocation may result in loss of revenue.

Quiet Enjoyment. In nearly every lease the landlord covenants that the tenant shall peaceably and quietly enjoy the premises without interference from the landlord or any person claiming through the landlord. The landlord makes this covenant to its experiential tenants and to its other retail tenants. In lease negotiations with experiential tenants, landlords often are wary of any disruption that customer traffic, music, or other noise may cause its other tenants. Consider how a gathering crowd before doors open for a performance or the sound of striking golf balls might affect other retail users such as a dentist's office or a clothing store. On the other hand, the tenant cannot make its investment in the premises without assurances from the landlord that its intended uses will not be considered to interfere with the center operations.

Insurance. Experiential tenants also require a fresh look at standard tenant insurance obligations. As a best practice, a landlord should have the use evaluated by its insurance broker or risk manager to confirm that additional requirements are not necessary.

M*iscellaneous – Parking, Signage, Exterior Alterations.* Experiential tenants will have unique needs for advertising, exterior signage and exterior alterations, and are often heavy users of shopping center parking. To ensure a positive landlord/tenant relationship during the term of the lease, and to avoid surprises and disputes, a well-prepared lease should include the details of each party's expectations for use of the common areas and other tenant rights.