

ANCHORS AWAY – A DEEP DIVE INTO THE CO-TENANCY WATERS

CO-TENANCY 101

I. Types of Co-Tenancies

Possession Co-Tenancy

- Tenant is not required to accept possession unless either: (i) landlord has binding deals with certain named tenant(s) or a certain percentage of tenants; or (ii) such named tenant(s) or a certain percentage of tenants have actually taken possession
- Most common in new or redeveloped centres where the tenant may have been attracted to the centre by the promise of certain named tenants or in circumstances where the tenant would like to ensure that it will not be forced to accept possession and build out until the co-tenants are secured

Opening Co-Tenancy

- Tenant is not required to open for business unless certain named tenant(s) or a certain percentage of tenants are open for business in the centre
- Most common in new or redeveloped centres where the tenant may have been attracted to the centre by the promise of certain named tenants or in circumstances where the tenant would like to ensure that it will not be forced to open and start paying rent if other tenants are delayed in opening

Operating (or Ongoing) Co-Tenancy

- After the tenant's initial opening, the tenant is not required to remain open for business unless certain named tenant(s) or a certain percentage of tenants are open for business in the centre
- Applicable to all centres given that one of the perks of being in a centre is the traffic generated by tenant synergies

II. Key Terms in a Co-Tenancy Provision

Triggering Event

- Typical triggering events include:
 - certain key tenant(s) are no longer open for business; or
 - occupancy threshold – a certain percentage of tenants in the centre are not open and operating
- In some cases, a strong tenant may include both triggering events in their co-tenancy
- Key tenant(s) may be a traditional anchor tenant (i.e. department store or grocery store), a certain number of major tenants/junior anchors (i.e. stores approx. 15,000-30,000 sq. ft.), or certain named major tenant(s)/junior anchor(s)
- Given the current retail landscape, it is important that landlords are able to substitute a replacement tenant if a key tenant is no longer operating

Replacement Tenant

- Landlords and tenants should consider which of the following criteria are applicable when determining suitable replacement tenant(s):
 - Same size and status
 - Same type of merchandise
 - Same quality of merchandise
 - Same type of customers
- Landlords should be wary if tenants have approval rights for replacement tenant(s) if the use of the replacement tenant is not substantially the same or the merchandise sold by the replacement tenant is not of equal or better quality than the originally named tenant
 - If a key tenant became insolvent, it may be impossible for the landlord to find a replacement tenant selling the same merchandise at a similar price point as the key tenant (consider, for example, Danier Leather) given that there is a reason the key tenant's business was not successful
- Landlord may want the ability to replace a co-tenant with multiple co-tenants instead (i.e. replacement tenant for an anchor tenant being three co-tenants leasing not less than 20,000 sq. ft. each)

Timing

- There are various facets to timing which are relevant to co-tenancy provisions
 - *Period of Time to Cure* – Are the tenant's remedies immediately triggered after the co-tenancy violation? Does the landlord have the opportunity to cure the co-tenancy violation before tenant can pursue its remedies?
 - *Sunset Clause* – If tenant has an ongoing remedy (i.e. reduced rent), should tenant's remedy continue until the end of the term or should it be subject to a sunset clause (i.e. rent returns to its full rate if tenant continues in centre after a certain period of time or landlord has a right to terminate the lease)?

Remedies

- Right to Close (or not open in the case of an opening co-tenancy)
- Reduced or No Rent
 - Risk that court may find the reduced or no rent a penalty and therefore unenforceable
- Tenant Early Termination Right (with Landlord reimbursement for unamortized leasehold improvements)
 - Landlord reimbursement should only apply during the initial term as that is the length of time on which tenant based its original decision to enter the lease

Preconditions

- *Personal* – Co-tenancy is personal to the originally-named tenant (and its permitted transferees)

- *Not in Default* – Tenant is not in default under the Lease
 - Sophisticated tenants may resist this precondition as the tenant’s default can be minor and completely unrelated to the landlord’s failure to fulfill its marketing promises with respect to other tenants in the centre
- *Open and Operating* – Tenant was open and operating its business in the premises immediately prior to the triggering event
- *Sales Test* – Tenant demonstrates a decline in sales as a result of the triggering event
 - Tenant may resist a sales test as sales may increase even with a co-tenancy violation but not as much as they would have otherwise increased but for the breach

III. Unintended Consequences

Domino Effect

- If tenant has a right to go dark or terminate the lease as a result of the co-tenancy violation, there is a possibility of a domino effect if other tenants’ co-tenancy clauses are triggered by this tenant going dark or terminating its lease

Adverse Impact

- Adverse impact on the value of the shopping centre and the landlord’s ability to finance the shopping centre if the landlord’s rental stream is uncertain as a result of tenants’ remedies for a co-tenancy violation

Incurable

- Language in co-tenancy may be too restrictive so a suitable replacement tenant cannot be found
- Risk that co-tenancy violation cannot be cured and there is no sunset clause