As appeared in...

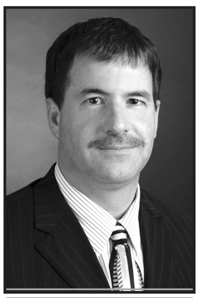
www.crej.com

COLORADO REAL ESTATE JOURNAL

THE COMMUNICATION CHANNEL OF THE COMMERCIAL REAL ESTATE COMMUNITY

JULY 21, 2010 – AUGUST 3, 2010

Retailers: Improve, standardize leases in this down economy



Andy Pidcock
Partner, Retail Services Group, Snell & Wilmer, Denver

In a normal economy, retail tenants are at the mercy of their landlord as landlords typically have all (or at least a vast majority) of the bargaining power when it comes to negotiating the terms of retail leases. After all, it is their property.

This is not a normal economy. The current economic downturn and softening of the commercial real estate market across the country has many landlords scrambling to fill vacant spaces and keep existing tenants from closing and vacating their premises. Many landlords have loan payments to make and the rent stream from their tenants is the main source of income for those loan payments. This situation creates a rare opportunity for retail tenants to renegotiate and standardize their existing leases, and obtain more favorable terms on new leases, than is typically possible in better economic times.

Obviously, this poor economy affects everyone including the retail industry. Some retailers have no choice but to close their doors and stop the bleeding on underperforming stores. However, for those stores that are borderline, a rent reduction could be the deciding factor between closing a store and keeping it open (and maintaining those rent payments to the landlord who, in turn, can then make its loan payments). Landlords understand this and for those who have lenders breathing down their necks, they are more flexible now than ever before when it comes to renegotiating an existing lease to keep a tenant's store from closing (and prevent the subsequent nonpayment of rent that often follows).

There are many ways to relieve some of the rent pressure on a tenant without putting the total burden on the landlord. This economy won't be bad forever and in many cases a short-term reduction of base rent over the next one to three years may be enough. When the economy and the tenant's revenues improve, the landlord can recoup some or all of the temporary rent reduction through a higher percentage rent factor or by adding the difference to base rent later in the lease term. In some cases, a tenant may be renting more space than it really needs to effectively and efficiently operate its store. Reducing the size of the tenant's space that is leased based on a per-square-foot rent amount will reduce the total rent obligation of the tenant and the excess space is then available to the landlord for other uses.

For those retailers who are doing well despite, or, in some cases because of (e.g., dollar stores), this economy, the world is your oyster. Expansion opportunities are boundless and there is no better time than now to find prime locations and obtain favorable lease terms.

No matter what the reason for negotiating or renegotiating a lease, whether to keep a store from closing, to take advantage of this economy or in connection with expansion to new locations, all multi-unit retailers can benefit from standardizing their leases.

Why standardize your leases? The following example exhibits some of the problems that can be caused for a business that has varying terms in its leases.

A Denver-based restaurant chain expands its business into the Dallas area. Typical of its other leases, it negotiates a five-year term with multiple five-year renewal options. Over the initial five years, the Dallas location achieves skyrocketing success.

Pleased with the success of the Dallas store, the restaurant company notifies the landlord 120 days prior to the expiration of the lease term that it wants to exercise its option to extend the term for an additional five years. Unfortunately, while all of the company's other leases require only a 120-day advance notice to exercise a renewal option, the Dallas lease requires 180-day advance notice.

The restaurant company is now at the mercy of the landlord. Its efforts to retain the prime Dallas location become marred by demands for dramatically increased rent and other concessions from the landlord. Ultimately, a decision has to be made. Should the company give in to the demands of the landlord to retain its current location (and now share more of its profits with the landlord) or should it take the business and financial risk of moving from such a successful location?

This is not an exaggerated example. It has occurred and does occur all too frequently. You can imagine the complexities of this situation for a company with hundreds of leases across the country and the additional risk exposure it would have if all of its leases have different key terms that are not properly tracked. By simply paying more attention to standardizing key lease provisions whenever the opportunity arises (whether negotiating or renegotiating a lease), this risk can be substantially mitigated or eliminated altogether.

In addition to the benefit of preventing a costly disaster like the Dallas example, a successful standardized lease program can save multi-unit retail companies a substantial amount of money. Beyond the savings of lower billings from outside legal counsel, a standardized lease program shortens the lease negotiating time and thus the time it takes to open for business in new locations and begin generating revenue.

Of course, obtaining the exact same key provisions in hundreds of leases across the country with different landlords is not entirely possible. The larger national restaurant and retail companies are the most successful at it because they are A-credit tenants and typically have the most negotiating power. However, in a down economy such as what we're experiencing now, even the smaller tenants have a unique opportunity to achieve greater success with their lease forms and they can reap the benefits of that success well into the future after the economy improves and the landlords tighten up their negotiating positions.

This window of opportunity for retail tenants will soon close as the economy improves so those who can should act now and act fast. ▲