

Real Estate Journal

THE LARGEST WEEKLY COMMERCIAL/INVESTMENT NEWSPAPER IN THE WORLD

Examining the pros and cons of a "co-tenancy" provision for shopping centers owners and tenants



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We all know what the downturn in the economy has done to people's shopping trends. Less money to spend, means less time spent in the nation's retail stores. This downturn in spending may have a secondary negative affect on owners of shopping centers; Not only will shopping center owners bear the brunt of tenants closing shop and/or declaring bankruptcy, but as a result of such closures, other tenants in a shopping center may be able to invoke their "co-tenancy" right. This may enable those tenants to pay reduced rent. This may be good for the tenants with such clauses (at least on the surface), but bad news for shopping center owners (and maybe for the tenants).

Many shopping centers tend to have at least one "anchor" tenant. An anchor tenant is a tenant who serves as the "anchor" of the center - i.e.: the drawer of customers, the tenant serving as the stabilizing factor in the center. Usually, these anchor tenants are national stores along the likes of a Target, a TJ Maxx, Marshalls, Big Lots, etc. Obviously, there is a perceived benefit to other tenants - big and small alike - to be part of a shopping center with such an anchor. That is, a well known tenant will hopefully increase the customer traffic to the center. Customers shopping at the anchor will hopefully patronize other stores in the immediate vicinity.

As a way of recognizing the importance of the anchor tenant, certain "non-anchor" tenants try to negotiate a "co-tenancy" provision. This clause works in one of two ways. First, with respect to a new shopping center development, the clause provides that, until such point as the anchor tenant opens for business, the "lesser" tenant will not have to open, OR, the lesser tenant may open for business, but shall be obligated to pay a rental different then the fixed rent stated in the lease. Similarly, with respect to an existing shopping center (or with respect to a new shopping center where the anchor requirement was met as of lease commencement), if the anchor tenant is no longer open for business, the neighboring tenants may invoke their co-tenancy clause, and their stated rental obligations will be abated, and such neighboring tenants will be subject to a different rental obligation. The

alternate rental arrangement is usually an amount equal to a percentage of the tenant's gross sales, but in any event not more than the "fixed" rental amount provided for in the lease. There is therefore no "downside" to the tenant for this alternate rental arrangement, as the neighboring tenant will in no event be obligated to pay more than their fixed rental amount, and in many situations, may pay well less than what was originally anticipated. While at first this may appear to be a "no-lose" situation for the tenant, there is a real detriment: foot traffic to their stores may decrease, thereby reducing their sales, and ultimately, their profit.

The affect on the landlord appears to be obvious. However, if there are co-tenancy clauses, the landlord may also face a decrease in rents from other tenants who have such clauses. What may not be quite as obvious is this: this reduced rent roll may have an ancillary negative affect on the landlord's financing. Often financing arrangements contain financial covenants requiring the borrower/landlord to show certain rental income levels. If the rent roll is no longer sufficient to meet landlord's financial covenants, the landlord risks defaulting on its loan. This reduced rent roll will also negatively impact the ability to refinance the shopping center.

As a consequence of the downturn in economy, landlords should review their existing leases to determine if they have co-tenancy clauses and if so, what they say. They should also review what impact such clauses have on their financing, both in effect and prospectively.

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