

The Worm Turns: Use Restrictions / 6 Practical Ways to Ink that Questionable Tenant

I recently attended a conference of real estate legal professionals in the shopping center industry. One of the topics of concern to “landlords” of shopping centers (malls and strip centers) was the inability/risk of putting a tenant into a center that might violate its own use restrictions by the very nature of their business. The economic crisis has left many centers with high vacancy rates and landlords are forced to consider leasing to tenants who have historically been located in stand-alone or lower quality sites. Some classic examples were tattoo, massage and funeral parlors. Usually, these uses are clearly prohibited by standard landlord use restrictions in order to protect the integrity of the center. However, these businesses have taken on new methods of operation which, if implemented properly, would not be a material hindrance to other tenants of the center. Nevertheless, tenants are increasingly using the strict interpretation of these uses as avenues to allege a default by the landlord where a default does not exist, in an effort to leverage the landlord into modifying or terminating their lease. So, before a landlord leases a space to a tenant whose use could potentially violate its own standards, the legal professionals at this conference offer the following suggestions:

1. Research

Carefully research the operations and financial strength of the proposed tenant. Is this tenant a mom and pop (Larry’s Ink Shop) or an established franchise (Massage Envy)? A landlord armed with the facts will be in a better position to (a) assess the risk of potential claims by existing tenants and/or (b) sell the new venture to existing tenants.

2. Plan

Prepare a business plan for the center which includes potentially unique tenants. If the proposed tenants meet the smell test (See ¶ 1) then the landlord can make viable arguments that the tenants will be valuable additions (*i.e.*: increased traffic flow, etc...)

3. Communicate

Existing tenants do not like to be anchored to empty centers. As such, the landlord should take pre-emptive measures to communicate with tenants a need to step “outside the box” to be able to fully lease the center. Suggestions such as “town hall” meetings to garner the input of tenants and obtain consensus are sometimes beneficial. When it appears the landlord is partnering with its tenants to achieve the resolution of a problem, modification/exceptions to use restrictions may be appropriate.

4. Limitations

As part of an overall plan, the landlord could suggest/propose to existing tenants that the use will be for a specified period of time and expire on a certain date and/or the use will not be renewed upon vacation of the

premises by the particular tenant. Tenants could rely on such measures as a temporary band-aid to get the center through tough economic times.

5. Revise

If the landlord has the unfettered right to unilaterally modify the restrictions from “time to time” the landlord could simply revise/amend the existing restrictions to provide for the use. However, this is considered a drastic and risky avenue which could potentially trigger a violation of the “quiet enjoyment” covenant if the use interferes with existing tenant’s operations. Further, it will certainly create an air of ill will on the part of existing tenants.

6. Future Leases

If and when the economy permits the development of new centers, all landlords should certainly review the current operations of businesses which historically posed problems and were restricted. For example, funeral homes are opening sales offices separate and apart from their operations, that should not pose problems. In short, landlords must provide for (a) flexibility in their use descriptions and definitions; and (b) a waiver of a default by tenants should landlords determine they must deviate from stated restrictions.

It’s not enough that the economy has leveled severe financial limitations on the retail industry, now landlords must deal with other issues not historically envisioned or addressed. These suggestions are only a sample of measures which can/should be taken to address this issue. Creativity and effective communication are the keys to successful resolution.