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Shopping Center Case Study

By Richard Abramson, Esq.
& Robert DiPisa, Esq.[1]
Cole Schotz, P.C.
Edited by the textbook Author

Project:	**[Project name withheld]**[2]
Asset Classification:	Retail
Sub-Classification:	Regional Shopping Center
Project Location:	Northern N.J.
Project Type:	New Construction
Status:	Completed
Property Type:	Industrial; Brownfield

Project Details:

- **Property Location/Address:** The Subject Site is located within a ten-mile radius of New York City, in northern New Jersey. The Subject Site is bounded on three sides by railroad tracks and a train station, a U.S. highway, and a general aviation airport, respectively.
- **Property Details**: 60-acre, former industrial site (manufacturing) with PCB's present.
- **Project Details**:
  - 582,000 sq. ft. Mixed-Use project comprised of:
    - 310,477 sq. ft. of Big-Box retail in two components:
      - Big-Box Retail A: 156,166 sq. ft.
      - Big-Box Retail B: 159,311 sq. ft.

[1] Richard Abramson, Esq. is a Member, and Co-Chairman of both the Real Estate Department and the Real Estate Special Opportunities Group, of Cole Schotz, P.C. He is a graduate of the University of Miami School of Law. Robert M. DiPisa, Esq. is an Associate at Cole Schotz, practicing in the firm's Real Estate Department and the Real Estate Special Opportunities Group. He is a graduate of the Seton Hall University School of Law. This Case Study was edited by the textbook author.
[2] To protect certain information proprietary to the firm's client, the Case Study authors have withheld information relating to the Project that might reveal information about the project that is not otherwise publicly available.

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    - ~16,000 sq. ft. Small-Scale Retail in seven buildings arranged around surface parking
    - 156,256 sq. ft. in a Mixed-Use building comprised of:
        - 147,296 sq. ft. of light industrial uses
        - 8,960 sq. ft. of general office uses

- Parties to the Transaction:
    - The Developer: The Developer is a privately held company.
    - Development Entity: The Development Entity is a New Jersey limited liability company.
    - Parties to the Transaction: **[Parties' names withheld to protect confidentiality]**
- Transaction description: See **Introduction**, below.
- Development Team:[3]
    - Architect: Regional architectural firm
    - Engineer: Local engineering firm
    - Land Planner: Local land-use planning firm
    - Landscape Architect: Local landscape architecture firm
    - Urban Planner: Local urban/municipal planner
    - Land Use Counsel: Local land-use counsel
    - Transactional Counsel**:** Cole Schotz P.C.
    - Construction Lender: Wells Fargo Bank, N.A.
    - Permanent Financing Provider: Commercial Bank
    - Property Manager: CBRE, Inc.

Legal Issues Presented:

1. How Exclusive Use and Restrictive Covenant Provisions in Commercial Leases with an Early Anchor Tenant May Impact Leasing Opportunities with other Anchor Tenants, as well as Non-Credit Tenants

2. The Impact Surrounding, Off-Site Uses May Have on Site-Planning for, and Operations and Maintenance of, a Shopping Center

[33] To protect the confidentiality of the client and this transaction, including nondisclosure of the name of the Project, the proper names of some the Development Team members have been intentionally withheld.

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3. What You Don't Know about Your State Liquor Laws May Hurt You: Requesting and Receiving Liquor Licenses for Restaurant Uses May Delay, Impede, and Even Scale-Back Shopping Center Tenanting

Introduction:

The development is a 580,000 square foot mixed-use project. Commercial real estate is generally broken down into the following major categories: (i) retail, (ii) industrial, (iii) office, (iv) hotel and (v) multifamily residential. For a time, these uses were kept separate, due to separate-use zoning (i.e., industrial uses were kept far from residential uses); however, in the last twenty-five years, thoughts on zoning have changed considerably, and mixed-use projects have become more popular. This particular mixed-used project consists of 422,000 square feet of retail use, which includes restaurant users; 151,040 square feet of light industrial use; and 8,960 square feet of office use. 310,477 square feet of the 422,000 square feet of the retail component (i.e. 73.5%) will be occupied by a warehouse club store on the western portion of the site, consisting of approximately 156,166 square feet ("Big-Box Retail A") and a big-box, general merchandise discount store, with a grocery, consisting of approximately 159,311 square feet ("Big-Box Retail B"). These two tenants represent 53.5% of the entire development project.

The light industrial use and office space is combined into one building located at the southern portion of the site, consisting of a total of 156,256 square feet, 8,960 square feet of which is made up of office space ("Industrial Tenant"). The remaining seven tenants, made up primarily of restaurant uses, comprised of just under 16,000 square feet, are located on the eastern portion of the site (collectively, the "Small-Scale Tenants"). A site plan for the development is provided below.

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Discussion of Legal Issues:

1. How Exclusive-Use and Restrictive Covenant Provisions in Commercial Leases with an Early Anchor Tenant May Impact Leasing Opportunities with other Anchor Tenants, as well as Non-Credit Tenants

While there were a number of issues surrounding the planning, construction, and proposed operations at the development, this section of the Shopping Center Case Study focuses on how exclusive-use and use restriction provisions in lease agreements, and the Easement with Covenants and Restrictions Agreement (“ECR”), together with the geographical location of the subject shopping center, helped shape the physical and operational attributes of this site.

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Generally, an exclusive-use clause in a commercial retail lease agreement prohibits a landlord from leasing premises in a shopping center to another tenant engaged in the same or similar business as an existing tenant. For example, a tenant that engages primarily in the sale of tacos and burritos may seek to prohibit the landlord from leasing to any other tenant who primarily engages in the sale of Mexican food. During lease negotiations, the tenant's objective is to make these provisions as broad as possible in order to limit or outright prohibit the amount of competitors or similar uses at a shopping center. This prohibition is intended to reduce the tenant's competition, presumably resulting in increased sales. The landlord will focus on negotiating these provisions as narrowly as possible, to allow the landlord more flexibility to determine the proper mix of tenants at the shopping center and to lease vacant space at the shopping center. By maintaining flexibility the landlord seeks to maximize the revenue from the shopping center and minimize vacancies, thus creating a more valuable asset. The larger and more popular a particular tenant is, such as a "big-box" store or other anchor tenant, the more attractive the shopping center will become to both patrons and smaller tenants alike. Accordingly, larger tenants are typically given preferential treatment when negotiating exclusive-use clauses because of the customer traffic and other benefits they bring to the shopping center. The desirability of the Developer securing a substantial anchor tenant, such as a Big-Box retailer in a regional shopping center, such as this, may be rendered even more acute by virtue of the Construction Lender's requirement that a minimum percentage of the project be pre-leased as a pre-condition for closing on the construction loan.

The ECR contains a restriction that the shopping center may be used for any lawful purpose of the type normally found in a retail shopping center, including financial institutions, service shops, offices incidental to a retail use, restaurants, theater and retail stores, subject to the terms of the Big-Box Retail leases. The ECR also contains a negative covenant prohibiting certain uses from being conducted in the shopping center. Some examples are as follows:

(a) any public or private nuisance; any adult cinema; massage parlor (except the foregoing shall not prohibit massages as an incidental use in connection with a health club, spa or cosmetics store), but excluding reputable national or regional stores such as "Massage Envy" or similar type of upscale

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massage operation; video store or bookstore selling, renting or exhibiting primarily any pornographic, lewd, suggestive or "adult" newspaper, book, magazine, film, picture or merchandise of any kind;

(b) any noise or sound that is objectionable due to intermittence, beat, frequency, shrillness or loudness;

(c) any automobile, truck, trailer or recreational vehicle sales, leasing or display, except for a Tesla showroom in the area shown on the Site Plan;

(d) any second hand store (excluding any high-end second hand store such as a store selling second hand designer clothing), or flea markets;

(e) any dry cleaning facilities utilizing hazardous substances with an on-premises plant; or

(f) any business or facility used in growing, delivering, supplying, dispensing or selling marijuana, whether by prescription or medical recommendation.

In certain situations, a retail lease may provide that the landlord is entitled to "percentage rent," through which requirement the landlord receives a percentage of the tenant's gross sales as an additional rent payment. In these types of leases, the landlord has an incentive to protect the tenant from competition to ensure that other uses at the shopping center do not negatively affect the tenant's gross sales.

On a macro scale, you can see how the exclusive use clause within a big-box tenant's lease, and the restrictions contained in the ECR, will determine not only the remaining tenants at the shopping center, but the type of services the shopping center will provide to the surrounding community.

In the present case, the exclusivity provision within the lease for Big-Box Retail A provided restrictions against the following types of uses: (a) a pharmacy; (b) a discount department store; (c) a dollar store; (d) a grocery store; (e) any ancillary uses associated with the foregoing; or (f) any use that is a combination of the foregoing uses. Moreover, each of these uses is defined in the exclusivity provision of the Big-Box Retail A lease. However, these definitions do not necessarily act to narrow the exclusivity

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provision for Big-Box Retail A, but to ensure that these prohibitions are not misconstrued or given an overly broad interpretation. By way of example, there is an exception within the definition of "grocery store" for restaurants that offer table service. This exception is to ensure that the term "grocery store" is not given an overly broad definition which would prohibit restaurants at the development, which is not a competitor of Big-Box Retail A and is not the intention of the grocery store exclusive.

While it may seem obvious that a grocery store is not intended to exclude restaurants, in addition to a grocery store's primary business of the sale of fresh and packaged foods for off-premises preparation and consumption, grocery stores continue to evolve and now provide large areas for prepared foods for on-premises consumption. Therefore, this provision could be interpreted to preclude fast casual tenants from selling food for consumption at home. These variations in interpretation warrant explicitly setting the parameters for and intention of each exclusive-use provision within a lease or other controlling document. Specific examples are also used within the definitions to ensure a clear understanding of the types of uses the tenant of Big-Box Retail A is trying to exclude from the development. For instance, the direct competitors of the tenant of Big-Box Retail A are explicitly listed within the "exclusive-use" section to ensure that under no circumstances would such direct-competitors be permitted to lease space and operate at the shopping center.

The exclusive-use provision set forth in the Big-Box Retail A lease also provides a more general exception to permit the tenant of Big-Box Retail B to use its premises for its typical retail business. While this may appear surprising, because you would think that the tenant of Big-Box Retail B is a competitor to the tenant of Big-Box Retail A, the fact that each is a "big-box" store does not necessarily mean they are direct competitors. By way of example, even though both Target and Walmart have fairly extensive Music and Electronics Departments, they might not necessarily exclude a Best Buy from going into the same shopping center, because there are some synergies between these retailers; if a customer can't find what it wants at one store, it can likely find what it needs at the other and vice versa. Similarly, the Sports and Camping Department of Target and Walmart might not object to Sports Authority being in the same center. In this case, Big-Box Retail A is a warehouse club, selling in bulk, and Big-Box Retail B is

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a general merchandise discount store, selling similar items individually. Many big-box stores act as "anchors" in the shopping centers they are located in, drawing in patrons due to size and name recognition. There can be multiple anchors in a shopping center, as you would see in a typical enclosed mall with several large department stores or in an open-air power center, which may contain several general merchandise stores as well as big-boxes that specialize in a particular type of goods such as pharmacies, electronic stores, toy retailers, and grocery stores.

In the present case, the use of Big-Box Retail B, associated with the sale of wholesale retail items, is not a direct competitor of, and actually complements the use being conducted in, Big-Box Retail A, which offers different items and increases patron activity at the site. Moreover, since the developer was in negotiations with the tenant for Big-Box Retail A and Big-Box Retail B at the same time, it was able to negotiate and coordinate both leases and the ECR in a way to ensure that each tenant's use would be permitted at the shopping center. If the Developer did not have the Big-Box Retail B tenant identified, it would be important for the Developer to anticipate which tenants might be interested in the shopping center and provide sufficient flexibility in Big-Box Retail A tenant's lease, in order to be able to lease the other Big-Box space more easily. Often, developers fail to provide the necessary flexibility in their leases, which could lead to an undesirable tenant mix or unanticipated additional costs.

In the present case, a consequence of the exclusive-use provisions in the Big-Box Retail A and Big-Box Retail B leases resulted in a high volume of restaurant uses within the Small-Scale Tenant spaces, because so many other, potential uses were excluded by either one or both of the Big-Box Retail leases' exclusive-use provisions. As discussed in section 3, below, the large number of attendant restaurant uses in the Small-Scale Tenant spaces in turn caused another problem—that of the availability of liquor licenses, which required a legislative solution. In fact, the landlord had to actively seek out non-restaurant uses to fill three of the seven Small-Scale Tenant spaces, depicted in the photograph on the left, with alternative uses to help diversify the offerings at the development, making the shopping center as a whole more attractive through the overall diversity of the products and

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services offered to customers. While it is arguable that having two big-box stores deterred other retailers from coming to the shopping center for fear the big-box tenants would carry the same products at a lower price, the restaurant carve-out within the exclusive-use clauses for Big-Box Retail A and Big-Box Retail B, respectively, permitted the Developer to create an area for patrons to get lunch or dinner after shopping at the big-box stores.

The forgoing discussion about exclusive-use provisions in retail leases in a shopping center not only shows how a Developer/Landlord acts to preserve the interests of larger tenants at the shopping center but also how these exclusive-use clauses eliminate entire classes of potential tenants, yet may also open opportunities for other uses that inevitably shape the identify and offerings a shopping center provides to the surrounding community.

2. The Impact Surrounding, Off-Site Uses May Have on Site-Planning for, and Operations and Maintenance of, a Shopping Center

As set forth in the Project Details section of this case study, the development is located adjacent to a general aviation relief airport. While these types of airports are usually smaller in size, this Case Study will show how both state and federal regulations associated with developments near an airport can have a significant impact on the physical and operational aspects of a regional shopping center.

Customarily, physical attributes of a development are determined by local zoning and planning laws. Planning and zoning boards of the municipality work closely with developers to approve plans and oversee construction of the development from inception to completion. Local zoning and planning laws not only regulate the size and shape of the development but the types of uses that are permitted in

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specific communities. By way of example, zoning and planning laws are what prevents developers from constructing a heavy-industrial processing or manufacturing complex next to a home, school or park.

In the present case, the development's proximity to the airport caused federal regulations to take precedence over some of the zoning and planning ordinances established by the municipality. These regulations, enforced by a federal authority, specifically control airports and the surrounding area, imposing different—and generally more-onerous—requirements on the shopping center than those required by the municipality. For example, not only did this federal authority regulate the height of each structure at the development, but it also controlled the landscaping and lighting plan to address safety concerns based on the proximity of the development to the airport's runway. Despite these constraints, the property's proximity to other densely populated towns and New York City provided the developer with an opportunity to create a successful retail center on a rare piece of undeveloped land large enough in size to support such a center.

Specifically, buildings at the site were not permitted to exceed thirty-five feet in height. While this may not significantly affect the Small-Scale Tenants it does limit the height of the big-box stores and Industrial Building to no more than two stories. It may also adversely affect some of the restaurants which construct elaborate entrances. Moreover, landscaping that would otherwise be in compliance with municipal zoning and planning laws was now also subject to federal regulation. The landscaping development plans had to be modified to accommodate federal regulations prohibiting the planting of trees or shrubs in certain parking areas to avoid interference with the airport. Lighting was the primary concern for the federal authority to avoid confusion between the lights associated with the shopping center and those of the runway. The row of lights in the parking lot of the shopping center may not be distinguishable from those of a runway from

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a pilot's perspective. Therefore, certain lights at the development were required to be mounted with federally regulated colored lights to distinguish the parking area lights from those of the neighboring airport, as highlighted in the photograph on the preceding page.

In addition to the federal regulations, two separate state authorities, one created specifically to regulate airports and the other tasked with regulating the preservation of wildlife, had concerns separate and apart from the federal authority. These concerns primarily focused on the maintenance and operation of the site to manage wildlife and avoid the congregation of birds that could damage planes landing and departing from the airport. These state regulations prohibit restaurant uses in areas surrounding airports to avoid the collection of food debris that attract birds, posing both a safety concern to the wildlife and the incoming and outgoing planes. In this case, the growing demand for restaurant uses within the Small-Scale Tenant locations made it imperative for the Developer to address and accommodate the concerns of the state authorities. Both authorities agreed to provide a special exception to the regulations so long as a wildlife hazard mitigation plan ("Wildlife Plan") was implemented by the landlord at the site.

The Wildlife Plan requires the landlord, among other things, to (i) post notices throughout the site instructing patrons not to feed the wildlife, (ii) install bird deterrents on building exteriors and signage, (iii) increase the monitoring of roof drainage systems and irrigation systems to prevent the pooling of water, and (v) install sophisticated technology to monitor waste removal at the site. More specifically, the landlord was required to fit-out the center with enclosed trash reciprocals (photo, right) that would electronically send data to the landlord's property manager when certain levels in the trash

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receptacles were reached. This method avoided the accumulation and overflow of trash on the ground that would attract the type of wildlife the plan was designed and intended to prevent. An approved list of plants was also provided to the landlord from the state authorities, to ensure that the types of plants at the shopping center did not encourage the nesting of wildlife. In addition, the state regulatory authorities also required that the landlord incorporate the restrictions set forth in the Wildlife Plan in each lease agreement with tenants at the shopping center. A violation of the Wildlife Plan would place a tenant in default of the terms of its lease and permit the landlord to terminate their tenancy if left uncured.

As shown in this section of the Case Study, the geographical location of the development influenced not only the physical appearance of the buildings, but the landscaping, lighting, operations, and lease agreements with all tenants at the development.

3. What You Don't Know about Your State Liquor Laws May Hurt You: Requesting and Receiving Liquor Licenses for Restaurant Uses May Delay, Impede, and Even Scale-Back Shopping Center Tenanting

The high volume of restaurant uses at the development, which was precipitated by the exclusive-use clauses in the Big-Box Retail and Big-Box Retail B leases, respectively, also presented a different type of issue: The need for liquor licenses for the sale and consumption of alcohol. However, the state law regulating the area where the development is located only permits (i) one liquor license for the consumption of alcohol for every 3,000 residents in a municipality and (ii) one liquor license for the sale of alcohol for every 7,500 residents in a municipality. Unfortunately, the development happens to be located in one of the most-sparsely populated municipalities in the state, with less than 100 residents, but surrounded by other more-densely populated towns. Therefore, not just the development but the town was only permitted to have one liquor license for the consumption of alcohol and one liquor license for the sale of alcohol. Based on the needs of the shopping center tenants, the developer needed two liquor licenses for the sale of alcohol, one for each of the big-box tenants, and three liquor licenses for the consumption of alcohol for three of the four restaurant uses in the Small-Scale Tenant locations, increasing the number of liquor licenses in the jurisdiction by 250%.

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Because state law prohibited the issuance of more than one liquor license for the sale and consumption of alcohol in this municipality, the only way additional licenses could be issued was by securing legislative approval. Therefore, the Developer had to lobby for new legislation in order for additional liquor licenses to be issued to the shopping center. Since the issuance of additional liquor licenses would arguably dilute the value of the only two liquor licenses in the municipality, the Developer's petition was met with strong opposition. Ultimately, the size of the development and its potential to generate substantial tax revenue and create approximately 800 jobs in the area outweighed the opposition. In a very controversial and unprecedented decision, the state assembly and senate approved the petition and the governor of the state signed legislation permitting the state to create five new liquor licenses to accommodate the development. These liquor licenses allowed the Developer/Landlord to secure the big-box tenants and ancillary restaurant uses at the development.

While in this specific case Cole Schotz was able to assist the Developer to overcome the obstacles imposed by both the state and municipality regarding the limited availability of liquor licenses, the foregoing discussion demonstrates how the geographical location of a development can impose unforeseen restrictions on the activities that are sometimes essential to the operation of the types of tenants and uses that a developer is trying to attract.