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economic development

Retail stress: Both landlords and tenants need to explore ways to achieve a common ground

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A few months ago, it seemed like the retail industry was experiencing a metaphoric Tsunami. We were pummeled with daily headlines regarding the demise of retail. The timing could not have been more inopportune: it was at the height of the holiday shopping season. In Connecticut, Linens 'n Things had just closed its last store, and Circuit City was on its last leg

heading towards bankruptcy.

Notwithstanding the behemoth that was the General Growth bankruptcy filing in April 2009, it is safe to say that compared to the auto industry, the retail industry is off life support – for now. The next few months will determine whether it will continue to breathe on its own on a long term basis.

Retail's Tripartite Terrain

The retail shopping center industry is not a monolith; it is composed of a heterogeneous mix. Although there are exceptions to each rule (the more recent "lifestyle center" phenomenon comes to mind), retail shopping centers generally can be categorized into three major types: the enclosed regional malls; the unenclosed power centers or big

box centers; and the neighborhood strip shopping centers. Each is known for a particular tenant mix. For example, the regional malls are usually anchored by national department stores such as Macy's, Nordstrom, J.C. Penney, Sears, etc. The power centers or big boxes on stand-alone pads are generally leased by tenants such as Best Buy, Walmart, Bed Bath & Beyond, Kohl's, Lowe's, Home Depot, etc. Neighborhood strip shopping centers have a bit more ubiquitous presence in the retail landscape in that they are generally anchored by grocery or drug chains and sprinkles of take-out restaurants, pizza shops and similar eateries. To be sure, some of these tenants do not fit neatly into these

categories, but the exceptions in these cases do not dilute from the general rule.

Remarkably, not all retail tenants did as badly a few months ago, or are doing as badly today. Of the three centers, strip centers, precisely because of their tenant mix, seem to have suffered or are suffering less decline in sales than the other two types of centers for obvious reasons: they sell basic necessity items that we need, so they have priority over the consumer's non-discretionary income. So while regional malls and power centers may be struggling to retain tenants, the traffic flow in strip centers remains relatively robust.

The Symbiotic Relationship

Because there are still distressed

landlords and tenants out there, both entities need to explore ways to achieve a common ground. For every recalcitrant landlord out there, there are two or three who are willing to make a deal with a tenant in trouble. Desperate times will require unconventional solutions. A diverse tenant mix – both in size and use – is equally as beneficial to the larger anchor tenant as it is to the landlord. The demise of one small Mom & Pop store in a Mall may hardly cause a ripple initially, but if a few of these less-than-large tenants continue to go dark, the domino effect would be both palpable and detrimental to the anchor tenant and the landlord alike. A fully-occupied and vibrant center no doubt benefits both.

A few months back, one of my developer clients stressed to me that landlords are seeking to build long-term relationships with their tenants: "It is about building partnerships." This philosophy is no less important today; it continues to be a symbiotic relationship – each relies on the other to some extent for survivability. To that end, landlords generally prefer that tenants take a more proactive approach in managing their bottom line. Troubled tenants need to approach landlords earlier in the process, rather than later regarding ways to ameliorate the tenant's economic situation. Although "Rent Abatement" seems to be the term de jour, these days, the term is hardly novel. However, a landlord will not offer a tenant rent abatement no matter how horrible the tenant's sales figures are, if the tenant's long-term survival in the center is hopeless. A landlord will not throw good money after bad just to be benevolent.

Once a request for rent abatement is made, the tenant should expect the landlord to ask for some concessions. These might include the unilateral right to recapture the space; or amending the lease to eliminate tenant-friendly provisions such as co-tenancy clauses, restrictive covenants or exclusives.

Anti-Darwinism: Negotiate to Survive

Ironically, the current retail terrain is one where the survival of the fittest might yield a lose/lose proposition. Granted, the terrain is not as bleak as a few months back, but it is still precarious nonetheless. For many retail landlords and tenants, negotiating well-considered and less strident solutions can effectively bridge the gap between these credit-strapped times and economic recovery.

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