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Taking a Fresh Look at REAs

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REAs among one or more developers, department stores, and, in the mixed use context, owners of parcels devoted to non-retail uses, have rarely been formulaic, but there are often customary approaches to handling some of the significant issues. Is it now appropriate to reevaluate some of those customary approaches—both business and legal? The following are some of the potential reasons to reevaluate.

Flexibility and Control: It may be useful to consider approaches to reconcile the customary push and pull between the developer's need for flexibility and the department store's need for control over the developer's activities. The recent economic turmoil probably cuts both ways. Department stores' control expectations may increase since many developers have failed to live up to their commitments to develop or redevelop projects because financing was not available or tenant expansion plans slowed dramatically. On the other hand, developers may be less likely to agree to heightened control by department stores because: (a) capital providers will also be more mindful of downside protections and (b) a greater number of developers are large REITS or other large companies that may be less willing to take risks than their smaller predecessors. Moreover, department stores that have been unable to dispose of unsuccessful locations might in the future be willing to trade some control for mutual flexibility.

Mixed Use Projects: Developers generally require more flexibility in mixed use projects. The configuration and density of the project and its mix of uses are frequently impossible to set in stone at the time the REA is finalized since entitlements may not be finally established, governmental requirements may change, and the market

for product type may change. Residential condominiums are a perfect example. In large mixed use projects, a department store, although always important, may be only one of several destination uses that draw customers and small tenants to the project. Accordingly, the department store is likely to cede more flexibility to the developer as to non-retail uses. Non-retail parcel owners (for example, a hotel) may also require certain controls over portions of the project outside its parcel.

Nontraditional Anchors: The relatively recent phenomenon of including popular large format retailers like Target and Costco in projects containing traditional department stores is presumably likely to continue. Coming from a power center (or stand alone) background, large format retailers have different expectations than traditional department stores. Their expectations will need to be reconciled and reevaluated on all sides. For example, some large format retailers are unwilling to covenant to construct or open for business (let alone covenant to operate). The problem for the developer is that it cannot simply concede the issue to resolve it. The department store may not be enthusiastic about signing a document that assumes the existence and operation of another anchor without an enforceable commitment by that other anchor. Additionally, neither the department store nor the large format retailer may be interested in signing an REA that looks substantially different from the form with which it has become comfortable.

Consolidation: The consolidation of development entities, the bankruptcy of unsuccessful developers and the inability of smaller developers to obtain sufficient

capital will likely result in the continued decrease in the number of developers. The number of large department store companies has also dwindled due to consolidation. There are fewer replacement department stores if one

decides not to join a project or later decides to close, and the consolidated department store companies are disposing of or re-branding one or more duplicate stores in a project. However, the smaller number of players may actually result in an increased comfort level for all parties that they will be able to resolve issues on a multi-project basis or at a high executive level.

Conveyance of Department Store Land and Improvements: If a department store closes, the developer may have a "recapture" right in its agreement with the department store, or the parties may come to an agreement at the time of the closure. Alternatively, the improvements (and entire parcel if the department store is the fee owner) may be sold to a third party. In either event, a non-department store use is a likely result. At the insistence of department stores, most REAs provide that each department store parcel is relatively unburdened by use, design and the other types of restrictions. This desire by the department store to retain significant flexibility may provide an unexpected windfall for a developer or non-department store third party that may wish to change the use or design of the improvements. CC

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