

**LJN**LAW JOURNAL  
NEWSLETTERS

# Commercial Leasing

## LAW & STRATEGY®

An **ALM** Publication

Volume 22, Number 11 • April 2010

## Reasons to Reevaluate REAs

*Part One of a Two-Part Article*

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**R**eciprocal Easement Agreements (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. The initial draft typically takes into account site-specific requirements and the known requirements of the parties. It reflects any available business term sheet and often utilizes as a template a document previously agreed to by some or all of the parties. It is usually vigorously negotiated over a substantial period of time. However, a substantial portion of the business and legal negotiations frequently occur at or near the margins. Historically accepted norms as to the primary provisions are not frequently controverted.

This article raises the issue of whether it is now appropriate to reevaluate some of those primary provisions — both business and legal. It focuses on REAs involving department stores, but many of the issues raised will be applicable to REAs involving other types of anchors and also to leases with both department store and other anchor tenants.

### REASONS TO REEVALUATE

Potential reasons to reevaluate include: 1) the troubled economy; 2) the trend toward mixed-use projects; 3) the inclusion of anchors other than traditional department stores as REA parties and the inclusion in the project of occupants that are not typical mall retailers; 4) the consolidation of both department store and development entities; and 5) the conveyance of department stores to the developer or to third parties for non-department store uses. However, retail has always evolved, and REAs have evolved with it. What is different now?

### FLEXIBILITY AND CONTROL: IMPACTS OF THE ECONOMY

There may be a heightened need to discuss approaches to reconciling the customary push and pull between flexibility and control. Developers have always sought as much flexibility as possible, while department stores have always

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sought as much control as possible over the developer's activities in the project. Developers have often accepted whatever flexibility the department store was willing to concede within the time constraints of getting the deal done, deferring to the department store's superior bargaining position. The hope was that, with good relationships and, for the larger developers, other projects to use as bargaining chips, they could resolve problems as they arose or, for less significant transgressions, request forgiveness after the fact rather than prior approval.

The recent economic turmoil probably cuts both ways. Many developers have failed to live up to their commitments to develop or redevelop projects as financing has dried up and tenant expansion plans have slowed dramatically. When department stores begin to commit to new projects, their control expectations are likely to increase. However, there are also contrary indications: 1) The developer's capital providers (both equity and debt) will also be more mindful of downside protections, including the need to make changes to the project without department store approval in order to reflect the market; 2) More of the developers themselves are large REITS or other public companies that may be less willing to take risks than their smaller, perhaps more entrepreneurial, predecessors. (There were a number of deals in the 1980s in which a successful West Coast developer of regional malls built a number of its projects while attorneys for the developer and the department store contemporaneously struggled over the details of the REAs and related documents. The developer induced

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the department stores to build their stores without signed documents by providing indemnities. Fortunately, the projects were completed and financed before the recession of the early 1990s, but the frequency with which this type of risk will be incurred is likely to diminish substantially, though not disappear. Last year, at least one such very large project, unfortunately, imploded after the investment of very substantial equity by the developer. In that case, however, the documentation was ultimately completed before the implosion.); 3) Department stores that have been unsuccessfully endeavoring to dispose of unsuccessful locations, stymied by use restrictions and site plan restrictions that impact not only the developer but also the department stores, might in the future be willing to trade some control for mutual flexibility.

### MIXED-USE PROJECTS

Mixed-use projects require that the developer have more flexibility for a number of reasons. 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 as the officials and their constituencies change, and the market for product type may change. (Think residential condominiums.) 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. The department store is likely to cede more flexibility to the developer as to non-retail uses (to a greater or lesser extent depending on relative location, parking requirements and similar factors). Non-retail parcel owners (for example, a hotel) may also require certain controls over portions of the project outside

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## REAs

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its parcel. Since neither the department store nor the hotel will want to allow the other to control its use and design flexibility, perhaps each can be persuaded to buy into a less restrictive control regime as to the entire project.

### NONTRADITIONAL ANCHORS AND OTHER NONTRADITIONAL OCCUPANTS

The relatively recent phenomenon of including popular large-format retailers like Target in projects containing traditional department stores is presumably likely to continue. Coming from a power center (or stand-alone) background, large-format retailers are likely to have different expectations from those of traditional department stores. These expectations will need to be reconciled and, in the process, reevaluated on all sides. (This issue is fleshed out further in Part Two of this article in the context of department store operating covenants. It also arises in other contexts.) For example, REAs with traditional department stores frequently utilize a "reasonability" standard of approval, with narrowly defined exceptions. Some large-format retailers are more likely to insist on a "sole discretion" standard of approval. The problem for the developer is that it cannot simply concede the issue to resolve it. 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. (This issue was resolved recently in a large mixed-use project by utilizing a previously negotiated but unsigned department store form REA as the primary multi-party document and also entering into a "mini" REA as a bilateral document between the developer and the large format retailer. The "mini" REA was not binding on the department store and afforded the large format retailer additional approval and related rights as to certain matters and as to certain portions of the project.)

Even in projects initially designed as retail projects (rather than mixed-use projects), the list of prohibited types of uses may require revision as religious, educational, governmental, temporary and other uses that may have been previously been restricted may be important additions to projects that have a high vacancy problem.

### CONSOLIDATION

It would not be surprising if the number of developers of large projects continues to decrease for various reasons, including consolidation of development entities, the bankruptcy of developers and the inability of smaller developers to obtain sufficient capital for large projects. Similarly, the number of large department store companies has dwindled, especially by consolidation. One resulting problem is that there are fewer replacement department stores if one of them decides not to join a project or later decides to close. Another resulting problem is that the consolidated department store companies were required (for anti-trust reasons or by market forces) to dispose of or rebrand one or more duplicate stores in a project. However, the smaller number of players may 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. Giving a concession in one project in return for gaining an advantage in another project (and similar trade-offs) has always been an integral part of the *modus operandi* of the shopping center business. The language in at least some provisions in an REA may, therefore, be less significant, and there may also be an increased expectation of more uniformity and less complexity in REAs.

REA forms have become large and cumbersome by accretion since one party's special concern in one project often makes its way into the REA for the next project, even if the concern were site-specific. The forms are infrequently reviewed to determine what provisions should

properly be deleted. This process should itself be reevaluated.

### CONVEYANCE OF DEPARTMENT STORE LAND AND IMPROVEMENTS TO THE DEVELOPER OR THIRD PARTIES

If a department store closes, it is likely that the developer will have an interest in acquiring the department store's land and improvements. The developer wants to avoid the negative impact a dark store is likely to have on the project, and may have plans for the profitable reuse of the improvements. It may have a "recapture" right triggered by such closure in its agreement with the department store (especially if it is a lease transaction), or the parties may come to a mutually satisfactory agreement at the time of the closure). Alternatively, the improvements (and entire parcel if the department store is the fee owner rather than a tenant) may be sold to a third party.

In either event, a non-department store use is a likely result (given the fact that the selling department store was unable to achieve success and the fact that the universe of department stores is limited, especially if there are other department stores in the project). 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 that burden the developer parcel (other than perhaps the list of "nuisance" uses) and that if a department store conveys such parcel, the transferee often becomes a successor party with virtually the same rights as the department store party. 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. Should this result be reevaluated?

### CONCLUSION

Part Two of this article will discuss operating covenants and monetization of real estate.

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