

# Pop-up To Permanent

**Turning temporary tenants into long term leases.**

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Once the domain of the seasonal Halloween costume store and holiday gift wrapping shop, temporary tenants and pop-up stores have become increasingly mainstream in shopping centers across the country over the past 3 years. Even major national retailers are getting into the act, like Toys ‘R’ Us Express.

But what happens at the end of a temporary tenancy? How does a landlord realign that short-term lease into a long-term landlord-tenant relationship? In this article, we review types of short-term tenants and both the benefits and drawbacks of temporary tenancies. We then discuss what the prudent landlord will want to consider before changing that temporary agreement into a long-term lease.

## OVERVIEW OF THE TEMPORARY/POP-UP TENANT

Temporary tenants pop up in the mall for a variety of reasons. Seasonal tenants want to sell products and/or provide services that are geared exclusively toward a forthcoming or just recently past holiday. Recall the center court display selling pictures with Santa. Other retailers may not have a seasonal product or service, but want to be in the mall during a holiday season to take advantage of increased holiday foot traffic to sell a limited product line to a larger audience.

Another reason for a temporary lease is the “experience” or “concept” store. Increasingly, national companies are using retail space to introduce new products, offer free samples, and engage with and educate returning and new customers. For instance, Procter & Gamble, manufacturer of household and personal care lines such as Olay, Dawn and Duracell, rented space at the end of last year at 57th Street and Sixth Avenue in Manhattan for its P&G brandSAVER Live pop-up. Visitors got free samples, money-saving tips and product information during live



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product demonstrations and free expert health and beauty consultations. Procter & Gamble not only got to interact with existing and prospective consumers, but also came away with contact information from many of its visitors who signed up to receive additional information and special offers.

## BENEFITS AND DRAWBACKS OF SHORT-TERM TENANCIES

Much has been written about the benefits that both landlords and tenants gain from a short term tenancy. Landlords (1) fill dark space, thereby alleviating problems with tenant mix, low occupancy, and co-tenancy failures, as well as combating the undesirability of a vacant center; (2) gain the caché of a new and unique tenant; and (3) get to try out a potential long-term tenant on a short-term basis. Tenants (1) test new products and get feedback firsthand from consumers; and (2) try out selling their product line in a mall setting if they are normally in strip centers, on the street, or even just on-line vendors, without committing to a long-term lease.

However, short-term tenants do pose drawbacks for the center. Mom-and-pop stores and entrepreneurs may have great ideas and a lot of energy, but they might not have capital, credit, or experience being a retail center tenant. In introducing many new shorter term tenants into a center, a landlord must be wary of hav-

ing too many of the same, overlapping uses, potentially upsetting the longer term tenants. Although a primary goal is to create occupancy to satisfy co-tenancy requirements, many long term tenants are objecting to landlords using temporary tenants to meet co-tenancies. Also, since temporary tenants often pay gross rent and no extras, landlords need to exclude their spaces from the calculation of other tenants’ charges. But other tenants do not want to subsidize temporary tenants, and those with clout may not permit the landlord to deduct the temporary tenant’s square footage in their pro rata share calculation. In the end, having a large number of temporary tenants filling up vacant space is just a duct tape fix — it will work for a while, but it is not a long-term solution. But is the remedy as simple as offering the short-term tenant a long-term lease?

Before a landlord jumps right in and offers an extended term to a short-term tenant, there are a number of issues to consider:

- **Review Leasing Commission Agreement:** Review existing leasing commission agreements to determine whether and how they address a tenant transitioning from temporary to long-term tenancy. The center manager may have leased up the short term space to reduce brokerage costs, but be sure the landlord is

not now liable to the broker for any fees associated with the transitioning tenancy.

- **Extend the Short Term Lease or Negotiate a New Lease?** If the landlord decides to give that temporary tenant a longer tenancy, the short term lease should not just be extended for a substantial term without reviewing it thoroughly. Quite often the short-term agreement is not even a lease; it could just be a two page license agreement. Many lease provisions landlords take for granted don't appear in the short term agreement, for the sake of getting the agreement signed quickly without much negotiation. The risk of "going without" may be minimal for a short term, but that risk increases significantly as the term lengthens.
- For instance, the tenant's maintenance and repair obligations may be very limited in the short term agreement, because there is no expectation that the temporary tenant will be doing any major repairs. During a long term tenancy, however, the landlord wants the tenant to assume all obligations to maintain, repair and replace the interior and storefront portions of the premises. Another example is percentage rent. While the short term deal may have been based only on a monthly fixed rent, the new deal may include percentage rent, which will require extensive provisions to define gross sales, provide for monthly and annual reporting, and permit landlords to audit sales. Tenants' insurance requirements could be limited for a short term, but with the longer term comes greater risk, and insurance coverage must be expanded, particularly if the

tenant will be building out an in-line space. The short term agreement may have prohibited assignment during the limited tenancy. For the longer term, however, the tenant will want to protect its right to assign and sublet in case things don't work out, or things work out so well that the tenant wants to spin it off to an affiliate or sell it to larger operator. Instead of trying to re-write the short term lease to add all the necessary provisions, it may be easier to negotiate a renewal lease on the landlord's standard long form lease.

- **Turning Common Area Uses to In-Line Tenants:** What started out as a temporary common area amusement center, or a massage chair or similar service, could turn into a longer term use in an in-line space. The question arises whether such entertainment or service uses are considered a "retail" use that will satisfy co-tenancies requiring "retail" uses. Also, other tenants often see entertainment or service uses as parking hogs. Their leases may prohibit them altogether, or restrict them to limited areas in the center.
- **Extra charges:** Short-term tenants often pay gross rent without contributing to common area maintenance costs, taxes, or marketing fees. Many do not even pay mall utility costs. The landlord will likely want the new long-term tenant to pay these charges. A tenant that has never been in a mall setting on a long term basis may not understand these charges, so the landlord must be prepared to explain why the tenant must pay more.
- **Use provision:** Because a tenant is only going to be in the mall on a

temporary basis, the landlord may not have vetted that tenant's use as carefully as with a long term tenant, particularly if the short term lease contained a mutual right to terminate on short notice. This would be a good time to check for conflicts with any existing exclusives or other use restrictions that other center tenants may have. Even if the landlord had previously checked those use restrictions, if the tenant wants to expand or change its use for the longer term, the landlord may want to check them again.

- **Tenant Improvements:** Under short-term leases, the temporary tenant takes the premises "as-is" and does little, if any, build out. Consider if the landlord now wants this tenant to improve the space for the longer term. The tenant may also expect a landlord contribution toward its build out costs.

In conclusion, turning that temporary tenant into a long term occupant of the center should not be done too hastily. Landlords will need to be sure that the new agreement will serve well for the long term. **SCB**

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