



REAL ESTATE
COUNSELORS



The Occasional Retailer:

When Office Landlords lease space to Retail Tenants



Bruce Rosen
BRosen@RECDC.com
(202) 577-3552



Mark Ricardo
MRicardo@RECDC.com
(703) 740-1765

A RECENT NAIOP EVENT CONFIRMED A CENTRAL THEME: The presidents of the major office REITs in attendance desired to own more mixed-use projects in the central business districts of large US cities. Although sensible given the changing demographics of our country, this strategy may create unique challenges for these traditionally office centric landlords.

One of the largest challenges is how to deal with the unique issues associated with leasing ground floor retail space within a larger mixed-use office building. This article addresses several of the most important issues that traditional office landlords should consider when leasing ground floor space to retail tenants

- **Toss the Office Lease Form** - Since the amount of office space in mixed-use office buildings usually far exceeds that of retail space, many landlords fail to take the time to develop a properly crafted, stand-alone retail lease form for their retail space. Instead, they often just take their form office lease and insert certain retail provisions. Unfortunately, this ad hoc approach often leads to an awkward blend of conflicting office and retail leasing concepts with poorly defined pass-through, operating and construction provisions.
- **Services & Access** - A major difference between office and retail leases is the level of services and access that the Landlord is obligated to provide to the tenant. In a typical retail lease, the landlord usually provides limited or no utilities and frequently provides no ventilation or janitorial services. In addition, most retail landlords do not maintain, insure, or restore a retail tenant's build-out in the event of a casualty



www.RECDC.com
DC ♦ MD ♦ VA ♦ NY

DC: (202) 577-3352
MD: (240) 252-3386

NY: (646) 820-3013
VA: (703) 740-1766



REAL ESTATE
COUNSELORS



The Occasional Retailer:

When Office Landlords lease space to Retail Tenants

- **Services & Access** - In contrast, office landlords often install, insure, and restore an office tenant's leasehold improvements if damaged. With respects to building and premises access, an office landlord may also not provide retail tenants with elevator and/or lobby access, if the leased space has a street level storefront or other stand-alone entrance.
- **Base Rent & CAM** – Unlike most office leases in which base rent includes all or a portion of the tenant's allocable share of operating costs and the tenant only pays its proportionate share of increases in such costs over an established base year (i.e., a modified gross lease), most retail leases operate on a triple-net basis whereby the tenant pays its own operating costs separately from base rent. The different structure between these two types of leases can cause the following problems for a landlord.
- **Maintenance & Janitorial** – Unlike Landlords typically require their retail tenants to maintain their own premises since so much of a retail tenant's build-out is not "building standard." This would include the heating ventilating and air conditioning ("HVAC") system, which for retail space is usually not part of the base building's system. In addition to addressing ordinary maintenance issues, a retail lease should also address waste removal, pest and vermin extermination, as well as odors and noises coming from the retail space. As discussed, typically retail tenants are solely responsible for cleaning their premises and waste removal.
- **Utilities** - Unlike office tenants, most retail tenants obtain utilities directly from the service provider. If direct metering is not possible, a sub-meter or check-meter should be used to more equitably charge the retail tenant for its utility use. Restaurant tenants typically use a disproportionately large amount of water, so this may also be a concern for the landlord. If a sub-meter is to be installed, the lease should clearly state who should pay for such meter.



www.RECDC.com
DC ♦ MD ♦ VA ♦ NY

DC: (202) 577-3352
MD: (240) 252-3386

NY: (646) 820-3013
VA: (703) 740-1766



**REAL ESTATE
COUNSELORS**



The Occasional Retailer:

When Office Landlords lease space to Retail Tenants

- **Permitted & Exclusive Uses** - Unlike a typical office lease in which the tenant usually has the right to use its premises for any legally permitted office use, retail leases usually have much more detailed use provisions. The reason for this greater specificity is due to the fact that there are a myriad of uses for which a retail tenant could use its space. These uses, in turn, may have a detrimental impact on the building and/or its tenants. An additional consideration is that given that most retail space is visible from the exterior of the building, the landlord will want more control over what the tenant can or cannot do in its space. Therefore, most retail leases typically have a much more detailed, and heavily negotiated, use provision.

Most retail tenants (especially those with a national presence) will want the exclusive right to sell certain products or services at the building. This is known as an exclusive use right. However, as may be imagined, the scope of the exclusive use right typically is a heavily negotiated provision of any retail lease. Usually, the exclusive use right is limited only to the tenant's main line of business, even though the tenant's permitted use may be much broader. Depending on what products or services the tenant wants the exclusive right to sell, a landlord may view the request as an easy concession or a difficult constraint. One reason exclusive use provisions are difficult for landlords is that retail tenants also typically request broad use clauses allowing the right to sell a broad range of products on an incidental basis. This combination is problematic, and an office landlord leasing retail space will have to carefully consider the terms of any exclusive granted, as well as what competing uses or key tenants should be carved-out from the exclusive.

Conclusion - The issues discussed in this article are not intended to be an exhaustive list, but merely a guide to help traditional office landlords better address the unique challenges that may arise in leasing retail space in one of their mixed-use office buildings.



www.RECDC.com
DC ♦ MD ♦ VA ♦ NY

DC: (202) 577-3352
MD: (240) 252-3386

NY: (646) 820-3013
VA: (703) 740-1766