Hot Topics for Commercial Property Owners and Managers: 2019 Update

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On February 19, 2019 Arnall Golden Gregory's Retail Industry Team presented its 5th Annual Hot Topics for Commercial Property Owners breakfast briefing. This year's panel focused on a couple recent major court decisions impacting the commercial real estate industry, which led to a comprehensive discussion about the changing face of retail. AGG Retail Industry Team Co-Leader, and real estate litigator, David J. Marmins moderated a panel that included AGG real estate transactional lawyers Brian Smith and Russ Arouh.

Brick & Mortar Wins Fair Tax U.S. Supreme Court Case

"The Internet's prevalence and power have changed the dynamics of the national economy," United States Supreme Court Justice Anthony Kennedy wrote for the majority in one of his last major opinions, South Dakota v. Wayfair. The Wayfair case acknowledged the "tax shelter" retailers benefit from by not having to charge state sales tax on items it sold over the internet to customers in which the retailer did not have a "physical presence", such as store, warehouse, or office. Last year, the Government Accounting Office estimated that state and local governments were losing between $8 billion and $13.4 billion a year in uncollected taxes for online sales.

In Wayfair, the Supreme Court put an end to the "physical presence" rule, instead allowing South Dakota to charge sales tax on sales made in South Dakota as long as the retailer has an "economic presence" regardless of whether it has a store of other physical location. Many states have now followed South Dakota's lead, including Georgia, which recently put into effect an economic presence standard providing that retailers who sell at least $250,000 in sales or make at least 200 individual sales in Georgia must either collect sales tax on purchases or send "tax due" notices to its customers that spend more than $500.

Simon's Aggressive Strategy to Keep Tenants Open Finally Pays Off

Whether Wayfair' evens the playing field for brick and mortar stores competing with online retailers remains to be seen, but the country's largest mall owner, Simon Property Group is taking the fight to tenants who say they can no longer compete and are terminating leases early. After failing twice against other retailers, Simon got an Indiana trial court to grant an injunction forcing Starbucks to continue operating its Teavana stores. Teavana announced it was closing 77 of its locations at Simon mall regardless of the lease terms. Simon argued the widespread closings would leave key storefronts dark, causing irreparable damage to the rest of the mall and its tenants. The Court agreed, finding that the relative harm in closing the stores to Simon outweighed the harm to Starbucks to keep the stores open. This was apparently the first time a US court forced a non-anchor store to abide by its continuous operation lease term as opposed to only being liable for monetary damages.

Not long after Simon's victory, the owner of Bellevue Square, a Washington state shopping center, won a similar victory against Whole Foods, convincing a state court judge to force Whole Foods to continue operating its "365" store. In this case, the court determined that the 35,000 square foot store was a primary reason people came to the center, and its early termination was doing irreparable harm to the rest of the center.

Property Managers Must Adapt to the Changing Retail Landscape

These cases evidence the evolution of retail and shopping centers. The days of anchor-based shopping malls packed with apparel stores and food courts are fading. Instead, successful malls are redeveloping anchor space to suit alternative types of tenants, adding "experiential" offerings, entertainment uses, nicer restaurants, food halls and other non-traditional retail space. These new uses come with their own unique concerns that should be on the minds of property managers.

The examples of these trending uses are growing daily in our industry. Theaters today are typically accompanied by the sale of prepared food and alcohol. Bowling alleys are no longer the dark smoky places they once were. Today, bowling alleys are found in vibrant 50,000 square foot multi-venue entertainment centers that offer arcade games, laser tag, and billiards, together with waiter service of prepared foods and alcohol. In addition to uses that have existed for decades, but have morphed in recent years, many other entertainment uses have exploded onto the scene. Today developments include indoor skydiving, golfing, and even axe throwing! (Yes, axe throwing is a real thing – envision darts for adults dressed in plaid).

All of these uses present unique challenges to achieve the appropriate balance between allowing the tenant to operate its business successfully while offering protections to the landlord to ensure that the entertainment use does not interfere with the operations of the balance of the project. Noise, lighting, alcohol, and security concerns are just some of many items that should play a role in lease negotiations between a landlord and prospective entertainment tenant.

Anticipate Noise, Lighting, and Other Issues at the Time of the Lease

Noise is an increasing concern relating to alternative use tenants. This is especially important where the entertainment tenant is inline and shares a common wall with another tenant. Landlords and tenants must determine who is responsible for noise concerns, complaints, at the onset of construction of the premises and throughout the tenant's term. Many of these concerns can be mitigated by the use or sound attenuation materials, but the installation of these systems gets far more expensive once construction is completed and the walls are closed up. So, it's important to consider noise concerns early in the process.

During lease negotiations, the construction exhibit that describes landlord's and tenant's work should determine the responsibilities for noise attenuation and remedies for any failure to attenuate. Such noise attenuations should be laid out in the work letter because a landlord will want to consider potential noise problems proactively, rather than later when problems might start to occur. A landlord will be worried about any noise that may affect other areas of the project and adjacent premises and will want tenant to be responsible for maintaining such noise. However, the tenant will want the landlord to be responsible for maintaining the noise.

Many entertainment venues operate late into the night, often until 2:00 A.M., which hours are considerably later than those of a traditional retailer. As such, entertainment tenants have additional considerations when it comes to operating late hours like, common area lighting, use of outside patio areas, and other safety concerns. The developer's or landlord's late-night concerns will be amplified if a project contains a residential component.

Such "late night" tenants will want the common areas lighted for employees and patrons. Tenant and landlord should negotiate the number of hours following tenant's hours of operation that require additional lighting. Typically, tenants require the common areas to be well lit for at least 2 hours after their close of business to allow employees to perform their post-closing activities and make it to their cars safely. Many of these employees earn cash tips so it is important that employees have a safe, well-lit path to the parking area. The requirement to light the common areas following the tenants' close of business is not controversial, but what does require some negotiation is allocating the cost of extra lighting. Typically, landlords agree to pay for some period of time after the tenants close for business (i.e., this is simply part of doing business with these types of uses at a property), but if certain tenants desire additional lighting for additional hours, they can share the extra cost.

Entertainment tenants must adhere to fire code restrictions that limit the number of occupants permitted within their

premises. Advancements in technology have done away with the traditional hand clicker or turn style methods of tracking occupancy. Now, electronic tracking systems have risen in popularity among entertainment users because they provide quick access to data by both a landlord and tenant. This allows the landlord to access critical safety information, and a tenant to track high volume operating hours so it can allocate staff accordingly.

As landlords and developers continue to adapt to the changing retail market, food halls and entertainment uses that create a memorable personal experience for the consumer are increasing in popularity. These “experiential uses” present opportunities for landlords and developers to deliver a product that generates excitement and draws patrons to the project. However, landlords and tenants must account for the operational and legal considerations that come with these new concepts. And, they must account for them during the planning phase, not when the problem occurs. The process for the design, development and implementation of these uses should be a collaboration between the landlord/developer, attorneys, brokers, property managers, and designers to ensure that the unique challenges of each project are addressed and understood up front in order to create a cohesive and successful project.

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