Don’t stop me now: Prohibited-use lists evolve

Not long ago, many American families spent a significant portion of their weekends on all-day retail journeys from the grocery store to a clothing store to the hardware store to the bank, all before the video-rental store on the way home in the evening. Today, however, the proliferation of online retailers and new technologies like Uber, Venmo and Netflix has changed this practice. Groceries and most other goods are delivered directly to our doorsteps, money transfers are two taps away on our phone and our smart TVs have more extensive content libraries than Blockbuster (RIP) ever did. Convenience has become dominant in American consumerism; you can order a new pair of Bonobos pants via Amazon drone delivery while watching Hulu on your iPhone in the back of a Lyft. However, this evolution continues to present new challenges for the retail real estate industry.

These changing consumer preferences manifest themselves in lease negotiations, specifically in the context of prohibited-use regimes. Standard in most retail leases and restrictive covenants, prohibited-use provisions govern how a tenant may occupy its premises. Typical prohibitions include nuisances and dangerous and hazardous activities, but also frequently include specific uses including the operation of a dry cleaner or restaurant in certain areas of a shopping center. With an understanding that landlords must maintain the flexibility to bring new desirable operators to modern mixed-use lifestyle shopping centers, prohibited-use lists must become shorter and more narrowly tailored.

For decades, prohibited-use regimes, often derived from a standard list attached to an anchor tenant’s lease form or declaration, were long and complex. Although the rationale behind many prohibitions derived from legitimate tenant concerns, including maintaining adequate customer parking and a desire to prevent “objectionable” uses that detract from the character of the shopping center, long lists created bind the hands of landlords in future leasing efforts. Consider, for instance, the following examples of prohibited uses commonly incorporated into retail leases over the past 20 years:

1. Recreation and entertainment concepts (e.g., bars, bowling alleys and movie theaters);
2. Gyms of all sizes;
3. Professional and service uses (e.g., medical, brokerage, post office and massage parlors);
4. Discount stores;
5. Nonretail uses; and

Lease negotiations that included long lists with these and other prohibitions took significant time to negotiate as tenants sought reasonable carve-outs for their operations. Additionally, and perhaps more concerning, expansive restrictions prevented landlords from retaining the flexibility necessary to adapt to changing consumer preferences and bring exciting new traffic-driving tenants to their shopping centers. Today, however, landlords and tenants are reevaluating the composition of an attractive retail shopping center and more closely scrutinizing prohibited-use lists. Operators and uses that would have been prohibited in each of the categories identified above are some of today’s most attractive additions to a retail development.

In the recreation space, craft beer taverns, movie theaters and even indoor ski facilities provide entertainment options that consumers cannot easily replicate at home with new technology. New fitness concepts including yoga, barre, Pilates and cycle studios operate in smaller spaces than traditional gyms without the same parking concerns (which in and of themselves have been significantly reduced by the proliferation of ride-sharing services). Service facilities have expanded to include boutique medical uses, retail postal stores, and real estate and financial brokerages, complementary to the other operators at the center. Discount department stores (e.g., Ross, T.J. Maxx and Marshalls) that are price competitive with the online giants are essentially the only remaining desirable soft good tenants operating in larger footprints. Finally, the reconsideration of event space prohibitions has allowed landlords to creatively utilize otherwise negative outdoor space for concerts, holiday displays, ice rinks and farmers’ markets that draw traffic to the center as a whole.

Simply put, developing and sustaining an attractive and modern lifestyle shopping center is incompatible with a cumbersome prohibited-use list with overbroad exclusions that crowd out desirable operators. Once unwieldy lists thrust into leases by powerful anchor tenants and prohibited-use lists are decreasing in length and scope, making lease negotiations shorter, reducing operations complexities for center managers and allowing landlords greater flexibility to respond to new consumer behaviors.

The proliferation of online retailers, the impact of new technologies and changes in consumer preferences have culminated in a reimagining of the traditional shopping center. Today, the most exciting new retail projects incorporate entertainment, multifamily, office and seasonal/temporary uses alongside traditional retail. These new and vibrant mixed-use development communities owned, operated and occupied by the very consumers who live, work and shop at the centers would not be possible with antiquated prohibited-use regimes that exclude some of the most cutting-edge tenants and efficient uses of space.

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