

TAB 3



The Six-Minute Commercial LEASING LAWYER 2015

3

Large Format Urban Retail Leases

Neil Skinner
Sobeys Inc.

February 18, 2015

Large Format Urban Retail Leases

Neil Skinner, Senior Counsel, Real Estate
Sobeys Inc.

As large format retailers reach a saturation point in suburban markets, many are exploring how they can achieve success in one of the last frontiers of traditional retailing – the urban market. The demographic trend towards an increasingly urban population together with Municipal and Provincial policies supporting urban intensification, have helped to provide a growing customer base within our city limits. Naturally, retailers are looking to capitalize on this opportunity and access these new markets. Walmart has already developed and rolled out several smaller format concepts in the US under the Walmart Express and Neighbourhood Market banners. Apparently Target is planning most of its 2015 growth (for its US operations) in urban markets using Target Express and CityTarget smaller format stores. As this trend evolves in Canadian markets, food stores, pharmacies, hardware and other large format retailers are developing, or refining, urban format stores that can work within a smaller footprint, have the flexibility to be customized for a specific location and respond to the diverse demands of the urban customer.

See: [small-format-explosion-coming](#) and [Target 2015 urban store growth](#)

What are the characteristics of a large format urban retail lease? Growing demand and competition among retailers for limited space in urban markets means a wide variety of locations and use combinations are considered suitable for these new format stores. The ground floor commercial component of a residential condominium is one of the development formats that may initially come to mind. In the past many condominium developments have declined to incorporate any significant retail space, however, more recently many developers seem willing to design for a mixed use concept that includes significantly more retail space on several levels. Retailers entering the urban market with a smaller format concept are seeking premises that range from 20,000 to 50,000 square feet rather than the 60,000 to 180,000 required for their prototype store. Occasionally there are urban developments that provide exceptions to those size limitations, but those opportunities are increasingly rare.

Furthermore, retailers may acknowledge that some urban communities have little appreciation

for a suburban format super store being squeezed into their neighborhood and that residents often oppose and effectively delay the developments that propose to accommodate them.

A suitable location for this smaller format could be in a new mixed use project, or a retrofit of an existing building, but typically shares the development with other retailers, or other uses and incorporates elements of a street front retail design (even if on the second floor). These premises often have no surface parking other than street parking, but will have dedicated underground parking, access to shared public parking, or no parking allocation where there is access to transit and pedestrian traffic volume is high.

See: [3 Interesting Retail Trends |](#) and [Walmart urban strategy](#)

Through some trial and error, early ventures into urban markets by large format retailers in Canada and the US have created a better understanding of how these stores can succeed and that these stores are not just a scaled down version of the power centre prototype. Urban stores have to reflect the needs of urban shoppers and respect that competition in the omnichannel retail environment can come from new and unexpected places due to new applications of technology, changes in customer demands and needs for new services.

See : [Walmart and omnichannel](#) .

As retailers work out their urban store concepts and look for new retail opportunities, lawyers need to develop a greater understanding of what new challenges retailers are dealing with in the urban setting and provide legal services that anticipate and effectively deal with new areas of potential risk.

1. Parking and Access

Changes to the amount of parking available and the convenient access to it are two of the biggest adjustments a retailer has to make in developing an urban design concept. The tenants typical form of lease may have previously stated a parking ratio and referenced a site plan to describe the parking, however, the urban retail lease will have to detail how various users of a mixed use project will share the parking provided, how the exclusive retail parking can be

protected for the retail customers use and the plan for vertical transport of customers and products. Failure to provide sufficient detail to address these issues early in a negotiation and provide certainty that the built form will reflect the preliminary approved design, can make it challenging for a retailer to get its final corporate approval for a location, lead to a late stage re-working of terms where the landlord may have to absorb the cost of re-design and construction changes, or adversely impact operations of the retailer and compromise the future value of the development. (Example: parking access for LCBO on Avenue Road north of Lawrence Ave. in Toronto).

Issues to consider include:

- Design and control of way-finding signage and exclusive parking area signage.
Having a site plan approval condition may not be sufficient to allow the tenant to confirm its signage requirements are met. Some municipalities will provide site plan approval, but defer the way finding signage approval for a subsequent review. Therefore, specifying a tenant approval condition for important elements of the design in addition to a general site plan approval condition can help a tenant ensure it has a right to provide input for those features.
- What parking control system will the landlord use and how will customer parking redemptions be coordinated with retail tenants?
- How will exclusive parking be controlled?
- If is there a 3rd party parking manager, how is the Landlord maintaining control and held accountable for maintenance and repair?
- Providing details on what parking control system will be used in four or five years may be challenging for a landlord, but this can be an important feature affecting the convenience of the shopping experience for retail customers. Specifying that the system has to be acceptable to the tenant, developed in consultation with the tenant, or similar to a system used in another specific location, may provide the certainty the tenant is looking for.

Sample clause for parking control:

(a) The Commercial Parking Spaces will be for transient, non-contract public paid parking and the Parking Facilities shall be drained, paved, lighted, and properly striped by the Landlord with access to the same floor level as the Premises. The Landlord shall not enter into any set term parking contracts for any of the Commercial Parking Spaces. The Commercial Parking Spaces shall be subject to an hourly parking charge with no daily maximum, at rates competitive with other public parking facilities within 500 metres of the Premises. Customers of the Tenant shall qualify for forty-five (45) minutes of free parking with evidence of a minimum \$15.00 purchase from the Tenant's store within the Premises. Once each year from and after the first six (6) months after the Commencement Date, if the Tenant determines, acting reasonably that the Commercial Parking Spaces are not properly servicing the parking needs of the Tenant and its customers, then the Tenant shall provide to the Landlord notice, requesting a material increase in the hourly parking rate charged and/or a change in the automated parking management system. Upon receipt of such notice, the parties shall, within 30 days thereafter, agree as to whether or not such an increase and/or change in the parking management system is required, in default of which the matter may be submitted to arbitration.

(b) The Landlord and the Tenant shall work together to develop a mutually agreeable mechanism for controlling and enforcing access to parking to ensure adequate parking is available for Tenant's customers, both parties to act reasonably and on the understanding that parking charges shall be no less than the average of other public parking facilities within 500 metres of the Premises as contemplated in paragraph (a) above. On the Commencement Date, an automated system will be used however it may be changed in accordance with subparagraph (a) above.

2. Loading bay design and access

To maximize the effective retail area, urban retail formats typically restrict the size of the back store to limit storage space. As a consequence, more frequent deliveries are needed and there is greater potential for conflict among retailers, or between retailers and other uses if loading areas are shared in a mixed use development. The retailer will have to determine if there are any restrictions on loading based on zoning by-laws, or in the case of a development including a residential condominium, require the developer to include the tenant's exclusive rights in the

condominium declaration so that the retail uses and exclusive rights are acknowledged by any purchaser or occupant of a residential unit.

- Is shared loading dock feasible or is exclusive required? Exclusive use may result in the landlord claiming the loading dock and any staging area form part of the leased premises.
- If exclusive, will the landlord maintain and repair the loading area and charge back , or will the tenant assume those responsibilities?
- How are goods moving from the loading area to the leased premises? Is there a dedicated elevator for the tenant, or is it shared with other commercial tenants?

These details will impact a number of operating cost allocations.

3. Development Approval and Completion

Where a tenant is considering space in a new development, documents may be negotiated three to five years or more before occupancy. If the lease is for a new retail concept, one of the tenant's main priorities will be flexibility in their retail program, whereas the landlord will need certainty on the banner name that will be operating and the fit with other retail tenants or occupants in the development. Incorporating some flexibility in the use clause will be critical for the tenant to maintain a variety of options for meeting customer needs in the omnichannel retail world as many retailers are still at the early stages of truly integrating their on-line and in-premises retail experience. In urban locations, more tenants may be using their physical locations as a delivery hub to provide a wider selection of products. This additional service may impact the use clause and also require changes to the access and parking design.

This is one of the reasons the tenant should avoid accepting any limitation on its permitted use, or using a reference to "similar uses in the majority of its stores" as a catch all descriptive term. A more suitable clause would use a reference to "similar stores in similar markets" or other language that is specific to this particular retail concept. Alternatively, the tenant's primary use

may be specified, but without restriction on ancillary retail sales to accommodate the need for various adjustments in the product mix and delivery of services.

In an urban setting there are more stringent urban design requirements often including limitations on broad frontage of retail units, demand for street front windows (without lifestyle images applied), signage restrictions and street-scaping requirements. Some of these complications for a large format store may be resolved by locating the premises on the second floor. Occupying second floor premises is still uncharted territory for many retailers which will require many adjustments to the layout plan to address changes such as:

- access from both the street and parking levels;
- location of the point of sale, or check out;
- storage of goods and access to loading bays.

To manage how these issues are addressed, tenants will need a detailed condition for approving any material change to the site plan. The Landlord can in turn limit the scope of this condition by defining a material change to be only where it is demonstrated that it will materially negatively impact the tenant's retail operations.

4. Issues with CAM and Operating Costs in new builds

Another issue related to the delay between signing paper for a deal and the tenant's occupancy and operation in the premises, is the risk that initial projections for operating costs will vary significantly from actual costs. This will only become apparent after the term has commenced and may result from costs incurred being greater than anticipated, design changes to utility services, or the allocation of costs not being clearly delineated or understood. This is a potential issue for any tenant in a new mixed use development, but takes on greater significance when the square footage of the leased premises is relatively large. There are several different approaches to allocating costs and the most suitable method should be determined by considering criteria such as the mix of uses, design of services, ownership and

management structure of the development and any obvious high intensity uses. Some of the issues to consider include:

- Using a proportionate share allocation based on floor area may not reflect actual consumption or benefit for different uses within a mixed use development. Keeping the proportionate share allocation isolated for each type of use (retail, office, residential) will help reduce claims that one type of use is supplementing another's greater use of a part of the facility.
- A detailed review of the development design, including specifications for services, may underscore the need for adjustments based on some shared elements being a greater benefit to some users more than others. Negotiating a list of exclusions to operating costs for a tenant may re-balance some of these items, but may also require more time to administer for all parties.
- Where sufficient detail regarding the project design and mix of uses is available, a schedule of cost allocations among tenants for all operating cost components can be included in the lease. The lease should also provide that, in the event a party determines the cost allocation is unfair, a third party cost consultant can be engaged to make a determination.
- Ideally the design of services will allow for separate meters, or check meters, but this may not be feasible or compatible with services that provide the highest efficiency and lowest operating cost for the development as a whole.
- Where the landlord is generating revenue from the parking facility from individual users, or through a parking management agreement, the tenant should insist on an exclusion of utility, maintenance, repair and replacement costs as these should be covered by the parking fees collected. Failure to exclude these costs permits a double recovery by a landlord.
- A landlord's form of lease will often have it retain the right to allocate costs as it may reasonably determine. If this is accepted because the project designs are still preliminary and changing, therefore preventing the completion of a detailed cost

allocation, the concept described above, of using a third party consultant to determine a fair cost allocation, could be included as a mechanism to resolve any disputes.

5. Measuring Useable Retail Space

The precedent lease for a large format retailer will likely have a simple method for measuring the rentable area of the premises using the outside of exterior walls and mid-point of partition walls. In a mixed use project the tenant will need to understand the impact of accepting a reference to a BOMA standard, which BOMA standard should be applied and what exclusions, or modifications, can be incorporated.

6. Conclusions

The unique details of each development and the specific needs of the retailer will dictate which of the issues in this brief overview are most important for the landlord or tenant.

Understanding the design and operation of the proposed development, together with knowledge of the tenant's objectives, is fundamental to helping them anticipate issues and mitigate risk with an effective lease document.