The Art and Science of Updating REAs

By David J. Rabinowitz, Kathleen Dempsey Boyle, and Brad Syverson

David J. Rabinowitz is a partner at Goulston & Storrs, PC in New York, New York. Kathleen Dempsey Boyle is of counsel with Pircher, Nichols & Meeks in Chicago, Illinois. Brad Syverson is vice-president of Real Estate and Research for JCPenney in Plano, Texas.

Thirty to fifty years ago regional mall development was a new frontier in retail real estate. Developers were often individual entrepreneurs who started in the business by developing small strip centers and then moving up to more complicated retail developments, such as enclosed malls. The original anchors of these new malls were department stores, which often preferred to own, rather than lease, their parcels and stores. Developers provided inducements to attract department stores to the new mall in the belief that they would drive customer traffic and thereby entice smaller tenants to open stores in the mall. "Drive customer traffic" was not only figurative but literal, as mall developers needed significant land, which usually meant parcels on the outskirts of town.

As the parties started contemplating this new type of retail development, it very quickly became apparent that they would need an agreement that would both govern their activities and protect their investments in this new shopping regime. Without such an agreement, lenders would be loath to provide funds for land acquisition and construction and there would be chaos. The agreement created to serve this purpose was called a Reciprocal Easement Agreement (REA). Typically, the parties to the REA were the developer and the department stores. The REA was recorded in the applicable land records, and thus all subsequent owners and tenants of the mall would be subject to the REA.

The REA often went by other names, such as a "Construction, Operation and Reciprocal Easement Agreement," "Declaration of Covenants, Conditions and Restrictions," and "Operating and Easement Agreement," but, regardless of the name, the substance of each was essentially the same. It set forth, among other things, construction and maintenance obligations, cross-easements for construction, access, utilities, and parking, opening and operating covenants of the department stores, permitted and prohibited uses, site plan controls, and which parties had the right to grant approvals under and amend the REA. In many instances, REAs also served as substitutes for zoning codes that either did not exist at the time or had not yet addressed the regulation of such large retail developments.

Given the large investment in capital necessary to build a regional mall, REA drafters intended for their malls to succeed and their REA docu- ments to last for multiple decades. That meant attempting to anticipate future trends both in retail operations and society at large. The cur-

Published in Probate and Property , Volume 28, Number 4, ©2014 by the American Bar Association. Reproduced with permission.

rent retail climate, though, has changed significantly from the early days of regional shopping centers. "Power centers" provide competition to regional malls and so-called "junior anchors" are on the rise. The department store sector has consolidated, and those remaining stores may not need the large footprint thought essential 30 years ago. Further, any operating covenants relating to the department stores likely have expired. This situation provides developers with an opportunity to reconfigure obsolete spaces and add junior anchors and big box retailers to fight off external competition and rejuvenate malls. That flexibility, however, may also mean that a department store may act as internal competition in its desire to reconfigure its own obsolete space, as department stores become "shadow developers" and pursue the same tenants as the developer.

This article, adapted by the authors from materials they originally prepared for the International Council of Shopping Centers' 2013 U.S. Law Conference, discusses carving out obsolete provisions and adapting REAs to the current retail climate. Before addressing that question, however, it is helpful to consider why the REA parties would choose to update the REA rather than simply let the REA expire. After all, many REAs provided for 40- or 50-year terms, so an REA entered into in 1976 is set to expire by 2026 or even 2016.

Aside from the desires of the REA parties themselves, the objectives of the lender and prospective new anchor REA parties are two good reasons to extend and update an REA. If the developer wishes to refinance the shopping center, the lender will require that the term of the REA extend not only beyond its loan term but also beyond the next lender's loan term, because the initial lender wants to preserve the value of its collateral so that it is a viable candidate for refinancing at the end of the initial loan term. This means that an REA may need to remain in force for 20 years after an initial loan's expiration.

New anchor entrants have concerns similar to lenders—they want to know that the shopping center has REA restrictions sufficient to give the new REA party significant control over development and operations. Therefore, a new anchor may require an extension of the REA for many decades (even as much as 50 years) as a condition to entering the center. The original department store anchors may have an incentive to keep older REAs in place because older REAs likely have cost allocations and approval rights that are favorable to the department stores, including rights to approve even the most miniscule site plan change.

Updating an REA— Global Issues

The parties should consider a number of recurring issues when updating an REA. As discussed in greater detail below, these issues begin with identifying the parties that must be involved in the updating process and go on to include a wide range of matters concerning the use of the property.

Approving Parties

It is important that the REA be reviewed to determine which parties are necessary to grant approvals and agree to an amendment. Typically, these parties would include the developer and the department stores, as well as the consent of the center's mortgagee.

The REA parties also must determine, however, whether a successor occupant will become an "approving party" under the existing REA. For example, a big box retailer that enters a shopping center is used to being an "approving party" under REAs in traditional open air centers and power centers and, as such, would expect to become an approving party under the existing REA for the mall. This may or may not be the case, depending on a number of factors. If the existing REA already provides that the owner or occupant of the building that the big box retailer will occupy is an "approving party" for purposes of the REA, then the big box retailer would succeed to those rights. But, if those "approving party" rights do not flow to a new owner or occupant or to a nondepartment store owner or occupant, then the developer and the prospective big box retailer have to evaluate the chances of receiving approvals from all necessary parties to amend the REA to grant the big box retailer "approving party" status. In doing so, consideration has to be given to what the other parties will seek in return from either the developer or the big box retailer (or both).

Site Plans

The site plan attached to an REA was originally intended to provide the "road map" for a shopping center's development. In addition to showing the expected initial development of the mall, it looked forward in time by identifying agreed-on no-build areas and permissible building areas (PBAs). But the site plan often became illegible after recording and years of photocopying. In other instances, certain areas were marked in color on the site plan with no surviving color key, or the original site plan could no longer be found. In any case, the crucial details referenced on the original site plan might no longer be ascertainable, and thus it is difficult, if not impossible, to discern the intent of the original parties to the REA.

Strict approval requirements for REA site plan changes, combined with the illegibility of the site plans themselves, led to a philosophy adopted by some developers of ambitiously interpreting (or ignoring) a site plan when making small (or ostensibly small) changes to a center and asking for forgiveness later if called out on a violation. The totality of small changes made over a number of years at some point makes the original site plan obsolete.

New legal requirements also might need to be addressed in an updated site plan because the usual standard for an REA is that it is never less restrictive than local zoning ordinances. This particularly affects parking configurations that may have changed over the years to meet ADA-required handicapped parking spaces and municipal requirements for the width and angle of parking spaces. Thus, when a large redevelopment such as a "lifestyle wing" requires a site plan revision approved by all REA parties, the approval process can become excruciating as each REA party examines the site plan to incorporate all previously approved or unapproved changes and current legal requirements.

Nonetheless, a site plan with more general delineations of parameters agreed on by the parties, accompanied by legible charts (such as for parking) and zoomed close-ups of necessary details, is still important and useful in shopping center development because those drawings permit the drafters to streamline the text of the updated REAs. When preparing a new site plan, consider making it flexible enough so that a party can make future modifications to its portion of the mall without having to go back for approvals from the REA parties.

Use Restrictions

Traditional REAs usually contain a laundry list of prohibited uses, some of which are reasonably classified as noxious uses that add unwanted noise or dirt (manufacturing or automobile maintenance, for example), truck traffic (warehouses), low grade residential uses (trailer courts, for example), and non-first-class retail uses (flea markets, for example). Most of these noxious uses are now addressed by zoning ordinances and may no longer be needed in the REA except as a security blanket for REA parties.

The REA likely will restrict uses to those "compatible with first-class shopping centers." The meaning of this phrase has been debated much more frequently in the last 10 years as developers have added discount department stores to regional malls. Is the reference to a "first-class shopping center" intended to mean a first-class enclosed regional mall or does it include other types of shopping centers as well? The debate continues today because developers, out of both intent and desperation, are looking to add big box retailers, restaurants, lifestyle wings, hotels, grocery stores, health clubs, churches, and other uses to their enclosed regional malls. Older REAs often expressly prohibit some nonretail uses that no longer seem to be so detrimental to a first-class shopping center. Examples include restaurants, theaters, bars, dry cleaners, offices, and commercial services such as brokerage and insurance offices or even medical offices. Such nonretail uses might be permitted under updated REAs subject to restrictions for permitted locations within the mall, height restrictions, square footage limitations (individually and in the aggregate), and parking ratio requirements.

Typically, older REAs did not anticipate the evolution of retail centers, and it is likely that the REA's use provision will need to be amended to permit a big box retailer's intended use, as well as the proposed redevelopment of the balance of the shopping center. For example, the REA may prohibit car washes and motor vehicle fueling facilities. These types of prohibitions may need to be changed for certain big box retailers that typically look to construct and operate a fueling facility and car wash on their parcels as part of their overall business.

Further, any lifestyle addition will affect the shopping center by bringing in new, different, and potentially competing uses. A key focus for anchors in assessing the compatibility of uses proposed by the developer for a lifestyle addition will be whether the new tenants draw traffic that will likely shop at an anchor store as well. Anchors also may ask for developer commitments relating to leasing up the lifestyle center so that it does not detract from overall mall leasing. These commitments can take the form of requirements for best or diligent efforts to lease or perhaps for new cotenancy requirements.

PBAs and Common Area Control

The developer will need to review the extent of the PBAs set forth in an REA to determine whether the PBAs include outparcels and expansions to existing buildings. Further, prospective big box retailers, lifestyle tenants, and new junior anchors will likely want to know what expansions can be made to existing building footprints.

The use of "control areas," long adopted by large restaurants and big box tenants, might be a worthwhile method for an REA anchor party to control uses in the area near its store, instead of permitting such party approval rights over every potential nonretail use throughout a shopping center. For example, any incoming big box retailer will require some level of control of common parking areas adjacent to its primary entrance, as well as over other critical areas of the shopping center, such as major internal roadways providing access to public roadways.

A big box retailer will want control over common areas to protect sight lines for its storefront and signage. Specifically, the big box retailer may try to limit heavy parking uses, such as restaurants, health clubs, and theaters, by requiring that those uses be located in designated areas in the mall far from the big box retailer's store and parking field. To protect existing sight lines to its store, the big box retailer may require the designation of specific no-build areas or PBAs. There is a limit, however, on what activities a retailer reasonably cares about that are located across the center from its store, particularly if there is no significant effect on access or visibility.

Exclusive Use Provisions

Many theaters, restaurants, and big box retailers expect to receive exclusive use protections that grant them the right to be the only occupant of the shopping center conducting a certain type of business or selling certain merchandise and that are designed to protect the store's core business from undue competition within the shopping center and a defined surrounding area. Further, big box retailers likely will not expect carve-outs for other anchor spaces (a typical regional mall concept). Although very common today in power centers and lifestyle center settings, exclusive use provisions are used less commonly in regional mall settings, with the exception of cases in which developers agree to protect a smaller tenant by stating that there will be no other competitors in a certain part of the enclosed mall. The developer and big box retailer will need to first determine together what is absolutely necessary to protect the big box retailer's business in the enclosed mall regime and then determine from a practical point of view what, if anything, they will be able to obtain from the "approving parties" under the existing REA.

Parking Ratios

The purpose of an REA's overall parking ratio requirement is to ensure that the shopping center has sufficient parking. The REA must be reviewed to see if the parking ratios are calculated on a parcel-by-parcel basis or for the overall development or whether the REA provides for different parking ratios for different uses (such as straight retail, restaurant, and service-type uses). For example, some older REAs may not distinguish among the different parking needs driven by different kinds of uses. The assumption was that across the whole mall, these differ-

ences even out. But new high-intensity parking uses, such as restaurants or theaters, may be required to provide additional parking spaces for their patrons. In addition, for a lifestyle wing of a center, the amount of unusual parking needs increases and becomes concentrated in one area because customers park for longer periods when using lifestyle amenities such as restaurants.

Although the overall parking ratio may be within the acceptable range, anchors will want to understand the effect of lifestyle-use parking requirements on their portion of the center. It may be appropriate to redefine the parking ratio requirements to take into account different kinds of uses. In terms of amending the REA, consideration should be given to providing the parties more flexibility in future years. Perhaps thought should be given to requiring only conformance with the applicable code. If that standard is adopted, consideration should be given to whether any party can seek a variance without the approval of the other parties. Using the code as a standard, but giving the other parties approval over variances, may allow for sufficient flexibility and protection for the applicable parties.

Signage

Although plenty of older REAs still have stringent restrictions on exterior and interior signage height and width, materials, and lighting, signage is one area in which REAs appear to be moving toward more flexibility with each amendment. The concept of simply permitting the customary signs used by national tenants is gaining ground, as well as a general coverage ratio for an occupant's signs on its premises.

Given the current emphasis on signage in zoning codes, it may be possible for REA parties to defer to zoning or to rely on general REA provisions requiring architectural harmony. New technologies in signage, such as digital and electronic moving signs, may herald an increase in enforcement activity (most REAs already preclude "flashing" signs), but conservative zoning codes that require occupants to jump through hoops to get a variance can be an effective check without requiring significant updates to REAs. Even if an REA provides significant flexibility regarding signs (or is nearly silent), the zoning code may preclude questionable signage practices.

Pylon signs, however, remain a contentious issue. More often than not, a big box retailer (or other non-anchor store) will require the presence of a pylon or monument signage and will expect a prominent position on such signage. Modifications to an approved pylon structure monument or location will typically require the consent of all parties to the REA. Instead of an amendment to the REA to accommodate signage modifications requested by a big box retailer, the developer may consider obtaining the written approvals of the required parties (which will likely not be recorded) as opposed to seeking a full amendment to the REA, which could be more time-consuming and costly.

Alterations vs. New Construction

Traditional REAs regularly require the same construction practices and approval standards for alterations as they required for initial construction. Because many early malls are in need of rejuvenation, REA parties may decide that such extensive requirements are not necessary. Instead, they may simply wish to focus on exterior renderings, sign compatibility, architectural harmony, and construction coordination.

Construction Coordination

Historically, REAs have been useful for imposing uniform construction standards on REA parties. Blackout periods for holidays (except for emergencies) and hours of construction outside operating hours have proven to be reasonable restrictions in practice. REAs also serve a useful purpose in requiring parties to keep as much customer access as possible via ring road reconfigurations instead of closures and alternative access to adjacent stores. Nonetheless, it is generally reasonable and prudent for anchors to request, and modern REAs to provide for, an anchor's approval of both construction phasing and staging plans.

The developer must lay out a comprehensive plan for constructing the various redevelopment projects. Most likely, the developer will build the construction timeline from the desired opening date or dates and work backwards. At some point in the predevelopment process of visioning, strategizing, identifying and recruiting tenants, and securing financing, the developer will be able to identify the opening dates with reasonable certainty. The desired opening dates are driven by the developer's objectives such as getting traffic back to the shopping center and adding rental income. The developer also may be racing to get open before another competing project opens, before cotenancy provisions for mall tenants kick in, or before a financing deadline expires. The realistic opening dates should be determined by entitlement and construction schedules, the retailers' approval processes, the retailer's limited opening dates, and the timing of funding. The developer's counsel should request high-level schedules and phasing plans with regular updates. Under the REA, anchors will have blackout dates for construction in common areas that generally focus on the Christmas holiday season—which may begin as early as October and run into January. Construction located within enclosed space should not be limited by such dates, however. Beyond the REA's provisions, anchors also may use other consent rights to reinforce their particular **phasing concerns.**

In redeveloping a shopping center, the existing tenants (and their customers) will experience construction traffic, staging areas, fencing, and barricades. Most likely, barricades, traffic diversion, and temporary mall entrance closures will occur. The REA likely will address all these issues and require consent of the REA parties related to placement, timing, and the effects of the above construction-related structures and activities. Consents will require identified staging areas, construction traffic routes, construction parking, barricade placements, signage on barricades, and parking accommodations. Also, the staging area and construction activity on an outparcel can affect visibility and sight lines to the remainder of the shopping center. Adding directional signage, rerouting traffic, redirecting employee parking, and additional pylon and building signage are frequent remedies for these issues. In addition, labor

issues can arise if some construction projects are union and some are not. An REA party's consent should address these issues, but the extent of the consent needed will be critical for finding workable solutions for the shopping center's overall redevelopment.

A further concern is the building's certificate of occupancy, which usually is required to allow the public into newly constructed space. The local permitting authority usually requires multiple certificates of occupancy that, although independent of each other, may be bound together by common requirements such as site work or even off-site work. In a shopping center, two different parties may undertake construction, and their certificates may be linked in ways such that issuance of the certificate for one party is dependent on the construction work controlled by the other party. The developer should carefully negotiate the conditions to the issuance of the certificates of occupancy as part of the permitting process.

Form and Content of Approvals

Finally, as generally discussed elsewhere in this article, the developer should consider how it will document the approved changes and what requests by REA parties may be included as part of such approvals. Alternatives include an unrecorded letter agreement between the developer and all or some of the required parties or a recorded amendment to the REA signed by all of the approving parties under the REA. Keep in mind that if only some of the REA parties enter into the letter agreement, it will not be binding on other parties who did not enter into the letter agreement. Other issues to consider when entering into these unrecorded letter agreements are their binding nature on successors and assigns, including a lender's taking over the developer's position in connection with a foreclosure.

Conclusion

Just as a new anchor store may condition its entry into a shopping center on the extension of an REA, anchor parties want to retain control over the developer's activities at a shopping center so that the anchor's interest in occupying what it perceives to be a "first-class" center is not threatened. The developer, in turn, wants to maintain, or increase, the flexibility for new development or redevelopment as much as possible. Ironically, in this new period of shopping center development in which redevelopment trumps new development, the interests of both anchor and developer parties are now more closely aligned than when new regional centers were being built. The recession forced the awareness that "time is money," and, in addition to deploying their finite resources on the real estate transaction itself, lawyers and architects must spend hours on detailed site plans and the revised text of amended REAs. Both developers and anchor REA parties are considering the benefits of simpler REAs that contemplate and address periodic redevelopment, a potential mix of uses at the shopping center, and updated technology and codes. If the parties recognize the broad topics that must be addressed in an REA, then they may elect to eliminate some provisions and rely on external factors such as zoning laws to enforce orderly development. Sometimes silence is the more practical and insightful approach. n