Leasing

Around the watercooler: Shopping center trends

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The national retail real estate conference in Las Vegas (ICSC) was only a few months ago, but already it feels like the market has shifted in the short time since. The conference provides a critical opportunity for landlords to connect with retailers, lenders, brokers and peers to get a sense of how the industry has shifted and, more importantly, what changes might be on the horizon. The informal conversations with players in the retail space and the undercurrent of discussion at the conference is a key element that can shed some light on what's coming next in the industry.

But these conversations don't need to be limited to a conference; in fact, some of the most valuable insights can come from informal discussions over coffee or lunch. Every few quarters, we touch base with the in-house leasing professionals for the two dozen or so regional and national retail shopping center owners/landlords active in Colorado to get a sense of what issues will be shaping retail lease decision-making in the future. After meeting with about half of the group this July, there seemed to be three narratives that kept coming up in conversation:

■ **Addition of CPI language.** While inflation was certainly one of the hotly discussed topics in May at ICSC, it has moved to front and center in conversations in the months since. With the inflation tracking Consumer Price Index cresting 9% for the trailing 12-month period in June, several landlords in the group have considered implementing CPI language that adjusts rents to inflation, larger fixed annual rent increases, or the addition of percentage rent language in their leases to help mitigate the risks of potential runaway inflation.

While retailers have much more flexibility in updating menu prices to match high inflation over time, fixed-rate leases (which often have a locked-in rent schedule for 15-plus years) can put properties and landlords at a competitive disadvantage during periods of high inflation. If inflation continues anywhere near its current levels, we foresee the potential for a widening gap in values for properties that have included inflationary protection language in their leases versus those that have not.

■ **More lease assignments.** The group noted that new leasing volume for quality retail has been through the roof and unanimously agreed that the volume of assignments (typically those where a shopping center tenant/lessee is selling their business to a new owner) is up significantly in recent history. There were a variety of theories as to what is driving this bubble of business sales, but a significant driver seems to be the push to beat imminent interest rate hikes since many business purchases involve some component of debt financing. Although most leases contain a fee associated with processing an assignment, the assignment process often represents a significant administrative burden to shopping center owners and often increases the default risk of the business by introducing a new operator. Landlords in the group have responded to this by updating assignment fees to better reflect market costs, adding new security deposit language to reflect heightened default risk during an assignment, or updating lease language related to the minimum industry experience or financial requirements of proposed buyers/assignees. Many in the group noted that tenants always should thoroughly review any assignment language in their lease and be prepared with the buyer's/assignee's application documentation when requesting an assignment to ensure the fastest turnaround time.

■ **Longer deal times.** Another recurring theme echoed was that deal times (the time between first contact with a potential tenant and when a lease is signed) have increased significantly in the last few years. Several factors seem to be driving the trend, but the largest seems to be the increase in requests for additional lease terms that were previously unusual for non-credit tenants. Things like variable guaranty structures, exclusive use clauses, and common area maintenance cap language, which were exceedingly rare for smaller deals, are being requested more frequently for owner-operated locations, which often leads to a more onerous legal review and approval process within the shopping center's ownership structure.

In addition, new lease language for post-pandemic changes around force majeure, more flexible permit timelines and parking lot flexibility for contactless pickup also has added to the complexity and time it takes to get new deals inked. Nearly all the landlords in the group noted they are working on efforts to shorten and simplify their lease forms to enable a faster deal flow. Combined with offer terms that seem to be shifting back to historic norms as retail vacancy declines, we expect deal times will shorten slightly into next year.

If industry buzz is any indication, retail landlords will continue the difficult task of perpetually incorporating new lease language to cover every new potential adverse outcome, while at the same time streamlining their processes so deals get done quickly. The most successful landlords, owners and property managers will be those who can leverage experience, data and insight in determining where to "hold" and where to "give" in retail lease negotiations on the spectrum of managing risk versus getting deals done. ▲

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