THE DAILY RECORD

Thursday, May 30, 2019 / Volume 111 / Number 104 / $2.00 • Western New York's trusted source for legal and real estate news

Real Estate LAW

Mall developments highlight the need for clarity in condemnation clauses

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Condemnation sounds ominous, but in commercial real estate, it is a business reality. Recent news of intended expansion at the Marketplace Mall highlights the importance of condemnation clauses in commercial leases, which are often overlooked.

The owner of the Marketplace Mall wants to use the eminent domain powers of the Monroe County Industrial Development Agency, Imagine Monroe, to condemn rights to parking spaces and certain easements held by existing mall tenants. While details of the intended development have not been publicly disclosed, the proposal is intended to lure a desirable anchor tenant to the mall. One current anchor tenant, J.C. Penney, is slated to lose nearly 300 parking spaces and be forced to close one of its main exterior store entrances.

The proposed Marketplace condemnation is similar to a condemnation that occurred in connection with the development of the DestiNY USA shopping mall in Syracuse in the mid-2000s, which led to several years of litigation among developers, retailers and the local development agency.

As seen with DestiNY and Marketplace, a taking may include not only square footage inside a leased space, but also parking spaces, sidewalks, signage rights, roads used for ingress and egress, and even contractual terms, like those giving a tenant the right to approve design elements or exclusive use rights within a certain area. From a tenant's perspective, parking spaces, especially those within a certain distance of high traffic entrances, may be of particular value. These lease rights may be as valuable as space inside a leased premises, but are likely more difficult to quantify.

A tenant has several options to consider in negotiating the terms of a condemnation provision as it relates to a partial taking. The parties must decide under what circumstances a lease may be terminated and what circumstances may give rise to an abatement of rent or other relief. Ideally, for the tenant, the tenant will have broad discretion to determine whether a partial taking has materially, adversely impacted the operation of its business, in which case the tenant may terminate its lease.

Many provisions base the tenant's relief on the percentage of square footage taken (i.e., the right to terminate upon a taking of twenty-five percent or more of the leased space). This approach fails entirely to take into account the loss of certain other contractual rights. Alternatively, a tenant may seek entitlement to an abatement of rent proportionate to the condemnation. The downside to this approach is that the impact of a particular condemnation is left to be determined and, in many instances, it may be nearly impossible to quantify the impact on a tenant of a loss of certain contractual rights. Lease rights of significant value should be specifically called out in the condemnation provision or elsewhere.

A landlord, on the other hand, should aim to limit the tenant's termination rights in the event of a partial condemnation. If a landlord agrees to a termination right, it should avoid granting a tenant the discretion to determine its applicability. One of the landlord's goals in negotiating a condemnation provision should be to ensure certainty in application. Landlords should keep in mind the impact that termination and abatement rights in the condemnation and other provisions may have on their ability to finance and market the lease in the future. As an alternative, a landlord may offer to replace the portion of the property rights taken in a condemnation. This approach has obvious application where square footage within a leased space is condemned, but may be more difficult to employ for purposes of replacing other less tangible rights under a lease. A tenant may agree to the concept of replacement in the event of partial condemnation, within certain parameters that ensure the replacement space or rights will be comparable to those originally granted (i.e., replacement parking adjacent to and not across the street from a retail space or replacement signage within a certain distance from the original sign).

Finally, at the time of lease execution a landlord may not anticipate the need for flexibility later. The Marketplace and DestiNY projects likely would not be possible without partnerships with local development agencies. If the condemnation provisions in existing leases gave tenants the right to terminate, utilizing the power of eminent domain for redevelopment projects or to attract new tenants may only lead to vacancies as a result of existing tenants exercising termination rights.

In commercial leasing, change is certain. Landlords and tenants should both prepare for change and employ careful drafting to avoid the unexpected consequences of condemnation.

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