**SUPERMARKET SWEEP**

Well-known grocery stores are typically the anchor tenant of choice for many neighborhood shopping center owners. Navigating the tricky world of co-tenants for that center can be another matter, however.

By Nellie Day

Grocery stores have been a shopping center darling for decades.

Why wouldn’t they be? The big chains are almost always listed as some of the top retailers in the nation, they provide a necessity, and they can motivate consumers to patron neighboring tenants before or after they’ve provided these necessities.

The problem is, grocery stores tend to know how attractive they are to the owners of neighborhood centers. This can produce an imbalance of power when it comes to negotiating leases, oftentimes creating a headache for landlords who must also deal with issues pertaining to co-tenanting, development and the long-term future of their centers.

“Grocery stores have always been reliable drivers of shopping center traffic, and the recent recession helped emphasize their value as tenants,” says Cyrus Rapinan, senior managing director at Los Angeles-based Rosano Partners. “The idea that grocery stores as anchor tenants will pull traffic to a center is embedded in the minds of landlords and other retailers. This gives supermarkets the advantage of being able to push for favorable terms in their lease agreements. For this reason, supermarket operators will continue to enjoy a strong influence in lease negotiations or lease renewals.”

**Exclusives**

The landlord’s goal is to create a successful tenant mix that is mutually beneficial to both grocery anchors and their co-tenants — thereby benefitting their own wallets. This strategy has become more difficult over the years as many anchors categorized as grocery stores have expanded their products and services to an extent that they may be considered competition to co-tenants, and vice versa.

“I do believe grocery stores will continue to seek to offer more services and merchandise,” says Donald MacLellan, senior managing partner at Faris Lee Investments in Irvine, California. “These types of retailers will continually adjust based on what sells. For example, over the years these grocery formats have added Starbucks’ kiosks to their stores.”

It used to be only drugstores and pharmacies that competed with the supplemental services provided by grocery stores. Nowadays, patrons can find a variety of products and services that might otherwise serve as stand-alone tenants. These additions now include everything from coffee bars and fast-casual outposts to postal and banking services.

“In recent years, grocery stores and big box retailers have been pushing for broader permitted uses and exclusive-use rights,” says Gregg Ankenman, an attorney with Wendel, Rosen, Black & Dean LLP in Oakland, California. “This blurs the lines between traditional uses, making it increasingly difficult to achieve and maintain an appropriate mix of tenants and uses in shopping centers.”

While grocers are happy to scoop up extra business, thanks to an in-store Wells Fargo or a Panda Express, it doesn’t quash their desire to ensure that co-tenants do not encroach upon their livelihoods.

“Typical supermarket exclusive clauses prohibit competition for the consumers’ food dollars within the shopping center. Without exclusive tenant types often include gourmet food stores, specialty bakeries, butcher shops, delicatessens, and drugstores that sell food and beverage.”

Exclusive-use rights can restrict the products and services allowed by another tenant at the center, essentially preventing competition that might affect a grocery store’s sales. When these anchor tenants also push for broader permitted uses that can potentially expand their offerings, a landlord can wind up between a rock and a hard place.

“It is critical for a landlord to preserve flexibility and be able to lease other space in the project to desirable tenants and to control the tenant mix,” Ankenman continues. “They should avoid overly broad permitted uses and exclusive-use rights. If a landlord must grant such rights, they should be as narrow as possible and build adequate limitations and carve-outs into the lease.”

These additional provisions could give the landlord some leeway, Ankenman says. He notes that some of the most popular limitations and carve-outs include allowing other tenants to hold “incidental” sales, limiting the exclusive rights for a grocery store to clearly defined portions of the center, excluding other major tenants or outparcels from these provisions and requiring that the anchor actually operate for the protected use if the exclusive-use rights are to remain intact.

**Spreading the Wealth**

Just as grocery stores have expanded their brands, so, too, have other retailers. Big box giants like Walmart and Target now offer grocery components, as do discount retailers like 99 Cents Only Stores and Family Dollar. As one might expect, this further muddles the waters in today’s tenant wars where every anchor increasingly wants to be all things to all people.

“Look at Super Walmart stores,” MacLellan says. “They typically require a larger list of exclusive uses to cover the various types of goods and services they offer. Super Walmart stores are harder to lease around because of the limited available uses they will allow. In addition to grocery and clothing, Super Walmart offers sporting goods, toys, automotive parts and services, an entire pet care section, optical services, in-store McDonalds and so on.”

MacLellan notes that all these exclusive uses typically result in Super Walmarts occupying stand-alone spaces in outparcels situated away from the main tenant mix. Though this strategy may work for Walmart, it is not necessarily the ideal scenario for a neighborhood grocer, he believes.

“Ideal shop tenants for grocery-anchored centers are typically those that complement the goods and services that the grocer provides,” MacLellan continues. “These can include a dry cleaner, nail salon, hair salon, cell service operators and food court tenants. Some larger grocery-anchored centers can include junior anchors such as TJ Maxx or Petco because, again, they are

Regency Centers’ Granada Hills Village in Granada Hills, California, is anchored by Sprouts.
largely not competing with the grocery store offerings."

Food and grocer tenants aren’t the only ones looking to provide all-encompassing service. It’s something landlords naturally have in mind as well. Just as grocers, big box and discount retailers have come to compete with each other over many of the same items, landlords are trying to stave off their own competition.

“Even with a large population base, the choices for retail options are enormous,” Rapinan says. “Take our daily grocery needs in a neighborhood like Mira Mesa [San Diego]. The choices are extensive and include general grocers, warehouses, discounters, ethnic grocers and premium grocers. These are all within a two-mile radius in this neighborhood. These retailers now are all competing for convenience parking for their customers,” explains Scott Burns, president of Wilson Retail Group in Los Angeles. “Major tenants that could jeopardize that are entertainment- and office-related users. Patrons visiting office- and entertainment-type venues will typically park for extended periods of time — much longer than a daily needs customer looking for the easy in-and-out experience. Similarly, customers of entertainment and office destinations are typically not as likely to cross-shop the area’s retail because their visit is business or social in nature.”

The issue of parking and non-traditional retail tenants is likely to gain steam as landlords continually try to evolve their centers in an effort to stay relevant. This will likely include the addition of health, wellness, food and beverage, entertainment and even office tenants like call centers — all services that can help a landlord combat potential losses from online sales. The idea of one-stop shopping also appeals to the tech-driven, instant-gratification consumer who now values convenience and efficiency. The services and amenities still need to be a logical fit, however, offered at competitive prices, and at the quality a customer expects.”

Bringing in tenants like gyms, day spas, health clinics, artisanal restaurants and movie theaters can be another tricky situation for any forward-thinking landlord trying to anticipate what the next big retail wave will bring.

“A landlord should keep in mind what they want to be able to do at the center over time,” says M. Rosie Rees, a partner in Pircher, Nichols & Meeks’ real estate department. “Don’t make any exclusive so broad or vague that it hampers your ability to bring in new tenants that aren’t really competitors of the big box or will affect the big box’s operations, so you don’t have to go back to the big box for permission.”

Like any meaningful relationship, the dynamic between grocery anchors and shopping center landlords will continue to evolve, hitting bumps and strides along the way. But like those relationships, both sides should appreciate the other’s efforts as they strive for a synergy that will benefit both parties, thereby keeping the relationship intact. After all, no one likes a dark anchor, and negotiating a new lease after a landlord chooses not to renew — or worse yet, litigation ensues — doesn’t benefit anyone.

Jud Dutrisac, COO of Costa Mesa, California-based Westar Associates, says it best. “The one constant in retail is change,” he says. “From a retailer anchor’s standpoint, it is critical they have the flexibility to adapt to consumers’ needs by offering different goods and services. Likewise, it is critical from a shopping center owner’s standpoint that they have the ability to service the end consumer by leasing space to tenants without unnecessary restrictions. In the end, the consumer will vote with their wallets and the best operators will continue to survive and thrive.”

"Supermarkets are first and foremost concerned about providing ample and convenient parking for their customers,” explains Scott Burns, president of Wilson Retail Group in Los Angeles. “Major tenants that could jeopardize that are entertainment- and office-related users. Patrons visiting office- and entertainment-type venues will typically park for extended periods of time — much longer than a daily needs customer looking for the easy in-and-out experience. Similarly, customers of entertainment and office destinations are typically not as likely to cross-shop the area’s retail because their visit is business or social in nature.”

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“It all comes down to convenience for the time-constrained customer,” says Justin Mendelson, senior director of Charles Dunn Company in Los Angeles. “There is a demand to bring in more services that fill customers’ appetites for convenience. The services and amenities still need to be a logical fit, however, offered at competitive prices, and at the quality a customer expects.”

As MacLellan mentioned, many grocers do have their preferred tenant mix. Many also have a laundry list of what they consider to be competitors to either segments of their business or their entire operations. Unfortunately, the list of “undesirable” co-tenants doesn’t normally stop there.

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