

Landlord Tips for Co-Tenancy Requirements

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When it comes to opening and co-tenancy requirements, some leases require that a specific anchor tenant be open and operating before a smaller tenant is required to perform its lease obligations, such as opening or paying full rent. Small shop tenants should address these issues in their term sheets or letters of intent, since their success is often dependent on foot traffic generated by particular anchor tenants. Landlords can protect themselves by considering the following issues in drafting co-tenancy provisions.

Define and broaden the nature, quality, and size of a replacement tenant



For a scenario in which an anchor tenant is to be replaced, co-tenancy requirements are typically satisfied by a “comparable” tenant. Since this can be left to a wide range of interpretations, the lease should clearly define the nature, quality, and size of a “comparable” replacement anchor. Must a replacement anchor be the same type of retailer as the initial anchor or just the same quality/class of retailer? Square footage requirements should also be considered since many retailers are shrinking the size of their prototypes. Must the replacement anchor be the same size as the initial anchor, or may it be smaller than the original anchor? May the requirement be satisfied by subdividing the anchor space into two or more smaller spaces and of what size? The answers to these questions should be clearly articulated.

Since retail centers tend to evolve over time, landlords should broaden the definition of acceptable replacement anchors. In many existing centers, big box tenants have already replaced traditional department stores. Many centers are being redeveloped with an emphasis on entertainment uses to draw in customers. Thus, a broader definition for replacement tenants should be acceptable to the tenant so long as the new use ensures that the center is active and vibrant. For example,

replacements for a major department store could include a grocery store, a big box retail tenant, a destination restaurant, a multiplex cinema, medical offices, a day care center, or other non-traditional retail uses.

Specify payment of alternative rent terms

A typical remedy during a period during which the specified anchor is closed is payment of alternative rent. Alternative rent may be a reduction in fixed rent or payment of percentage of gross sales in lieu of fixed rent. If alternative rent is a remedy, the lease should also specify if additional rent (CAM, taxes and like charges) is payable during the rent abatement period. Landlords should negotiate that tenants must prove diminished sales in order to be entitled to pay reduced or alternative rent.

Include a “sunset” provision

Tenants often negotiate for the right to terminate if the co-tenancy violation is not cured within a certain time period. Landlords should include a “sunset provision” on the tenant’s termination rights: For opening co-tenancy requirements, the tenant should be required to terminate or open and pay full rent after a certain period of time. For on-going co-tenancy requirements, if the tenant fails to terminate within the specified time period, it should be required to resume full rent and the right to terminate with respect to the specific violation should lapse.

Limits on tenants’ remedies

Tenant’s remedies should be conditioned on tenant not (a) being in default, (b) having assigned or sublet during the closure of the anchor, (c) having violated any radius restriction in its lease, and (d) exercising any option rights while the co-tenancy violation is ongoing. There should also be exceptions for closures due to casualty, condemnation, force majeure, assignments, remodeling, and repairs. The Lease should provide that tenant’s sole and exclusive remedies for failure to satisfy co-tenancy provisions are limited to the specific remedies set forth in the Lease.

Terms and conditions of anchor lease should be consistent with small shop leases

Finally, Landlords should make sure that the terms and conditions of the anchor lease regarding opening and continuous operation are consistent with the co-tenancy provisions in its small shop leases.

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