REAdy to Draft and Amend REAs? Pointers for New Developments and Redevelopments

By Kathleen Dempsey Boyle and Ruth A. Schoenmeyer

Kathleen Dempsey Boyle is a partner at Meltzer, Purtill & Stelle LLC in Chicago, Illinois. Ruth A. Schoenmeyer is a partner at White & Case LLP in Chicago, Illinois, and is chair of the Section's Leasing Group.

We all know that good fences make good neighbors. Do you know what else makes good neighbors? A detailed agreement that outlines their respective rights and responsibilities. That's where reciprocal easement agreements come in.

Sometimes referred to as REAs (or construction, operations, and reciprocal easement agreements, or declarations of covenants, conditions, and restrictions), these documents have been a favored tool of shopping center and other developers for decades. As old and new shopping centers morph into different kinds of developments, however, REAs must evolve with them. The REA that your grandpa drafted for this new-fangled thing called a shopping mall does not work for today's mixed-use development featuring office, hotel, residential, and retail uses. This article provides some background about REAs and includes tips for drafting new REAs and amending old ones to include sufficient protection for all owners and operators in a development, while also allowing them to develop the next big thing on all parcels of a development.

Background about REAs

Necessary Parties

An REA is either a one-party agreement (a declaration) or a multi-party agreement. Although both types of documents have the same effect on operations at a property, the distinction becomes important when considering approvals and transfers of all or portions of a development. This will be discussed further below.

Length of the Term

The REA is a recorded document, so all subsequent owners, tenants, and other occupants at a property are subject to the REA until the REA expires or is terminated. A traditional shopping center REA of the 1970s—many of which remain in effect—often had a minimum term of 40 or 50 years plus an automatic extension for as long as one or more anchor stores or parts of the main mall building were operating for retail purposes.

There are two reasons for such a long term. The first is that most of the initial parties to the REA probably did not envision a conversion of the development into uses other than retail, partly because retail development customarily carried a higher per-square-foot cost than other types of commercial development because of the higher level of finishes than those used in general office or warehouse developments. (This gap has narrowed as retailers have incorporated lower-cost finishes such as polished concrete floors and open ceilings in newer retail and restaurant developments.) Because of the high upfront costs, it seemed unlikely to shopping center developers of the past that their shopping centers would be converted to other uses in the future. Accordingly, the term of a retail-centric REA tended to be lengthy.

The second reason for the lengthy term was to preserve the financeability of an owner's portion of a center. Like ground lease financing, lenders want the term of an REA to be longer than the term of the lender's loan *plus* the term of the next lender's loan *plus* a cushion to ensure that the expiration of the REA is not coterminous with the expiration of that next lender's loan. From the lender's perspective, this preserves the value of its collateral for the next financing. Like ground lease financing, this may mean an REA term that continues for at least 20 years after the expiration of the initial loan. If the initial loan has a seven- or ten-year term, then the REA may need to have a minimum term of 30 years.

Subsequent buyers of all or portions of the new development also influence the term of the REA. Those buyers, like the initial REA parties, want control over the development and operation of their portion of the property. The buyers also want to preserve the benefits attained through an REA, such as cross-access easements, parking availability, and preservation of good visibility between public streets and their property. Because subsequent buyers are rarely replacement anchor stores but rather investor-operators like the original developer, however, those subsequent buyers may be looking for flexibility in the REA.

The REA in New Developments

Let's assume that a developer is creating a brand-new development with multiple buildings (and perhaps multiple uses) that will be subject to an REA. Besides a long term, what should the property owner-developer anticipate that lenders, tenants, and future buyers will expect to see in an REA?

The Basics

Whether for a simple shared driveway or for a million-square-foot development, an REA must contain basic elements. Those elements include shared access from and to adjacent streets and an occupant's premises; shared use of common areas such as parking lots, sidewalks, trash enclosures, sidewalks, and access roads; shared utility easements and the right to relocate utility lines on an adjacent owner's parcel; construction coordination for both initial construction and alterations, including (a) limits on truck access, (b) black-out periods for work, and (c) detail about staging areas; and allocation of maintenance responsibilities and expenses both for common areas and for the buildings and related improvements on each parcel of the development.

Site Plans

An REA usually includes a site plan delineating the boundaries of the development and the buildings, parking areas, access roads, and other common elements. Charts included on the site plan often establish the minimum and maximum square footage permitted for buildings, required parking ratios, and height restrictions.

Traditional shopping center site plans were colloquially referred to as "frozen" site plans, meaning that no one could change the size or configuration of buildings or common areas reflected on a site plan unless the REA parties amended the REA to update the site plan. This requirement hampered redevelopment unless an REA party was willing to pursue the lengthy, arduous process of obtaining all of the REA parties' signatures on a recordable REA amendment. Alternatively, an REA party could proceed with the redevelopment without approval and face the fall-out from the other REA parties later, in a "proceed then ask for forgiveness" approach. Because REA parties were often neighbors at multiple centers, horse-trading ensued.

To avoid these problems, the parties to new development might consider one of the following alternatives:

Simplify the Site Plan. One solution for a new development is to strip down the site plan to show only the most important matters, such as access and parking configurations, and to skip data such as maximum areas of buildings and per-parcel parking ratios. In considering how to preserve flexibility for new REAs, stripping down the site plan may help to maintain flexibility for changes in future use. It may also help to reduce the likelihood that future owners and purchasers of a property subject to an REA will be unable to read a busy site plan because of recording and photocopying.

Establish Zones of Control. Modern site plans may grant site plan control to an REA party over only that portion of the development that has the greatest effect on that party's operations, such as a view corridor to preserve sign visibility from an adjacent street, or a "no build area" to prevent congestion. Having approval rights over a limited area precludes an REA party from controlling the minutiae of a redevelopment plan far on the other side of the center from its premises, thereby preserving flexibility for future uses. The rights of an REA party to grant approval or consent should also be limited. For example, perhaps an REA party should be granted consent rights over the scope of expansions in its control zone because of the impact on common areas but should not be granted consent rights over the exterior appearance of buildings in such area.

Unnecessary Provisions

If a developer of a new redevelopment wants both to simplify the REA and to maintain flexibility for future changes to its development, the developer should consider which matters can be omitted from its REA. Here are several suggestions:

Parking Ratios. If a municipality has a zoning code with low parking ratio requirements for various uses (e.g., no more than 3.0 per 1,000 square feet of retail use), then the developer may elect to defer to zoning regulations rather than to impose a different standard in the REA. The developer is making a calculated risk that the political winds are relatively stable, but that may be the better choice than having to obtain approvals from REA parties to change the parking ratio.

Protection of Drive Aisles and Access Roads. The developer may care about preserving well-configured drive aisles or access roads that allow room for customer pick-up in front of stores or easy drop-off by vehicles for hire. Municipalities care about those things, too, and may require such details as part of the permitting and approval process for the development anyway.

Sign Criteria. Municipalities are often proactive regarding exterior sign requirements. Because sign requirements quickly become obsolete (remember those sign rules requiring letters no more than three inches tall and gold-colored plating?), sign requirements should be shifted to a development's unrecorded rules and regulations. Alternatively, the REA can simply rely on the municipality's signage requirements.

Prohibited Uses. Older REAs often include lists of restricted uses that go beyond a customary list of noxious uses that would already be precluded by customary zoning regulations. These restrictions—examples include restrictions against entertainment uses and spas—have proven to be obsolete long before the REA term expires. Accordingly, perhaps a list of prohibited uses can be left out of a modern REA.

Sample Site Plan. An example of a "modern" site plan for a retail center is included below. The site plan focuses on matters most important to daily operations, such as access ways throughout the center, with the critical access drives shown in dark gray and pedestrian protections delineated. The existing and to-be-constructed buildings are depicted, as well as the truck access and docks, trash locations, and trailer areas. Matters that are legally required at the time of development, such as handicapped parking spaces and pedestrian walkways, are clearly delineated.

Enforcement Issues

A key consideration when drafting an REA is determining who will enforce the REA over its long term. Customarily, all parties to an REA have enforcement rights against other REA parties, but not always.

Enforcement by the Declarant

The drafter of a declaration may elect to grant enforcement rights to one party, the declarant, and its successors. The key issue is whether there is a clear line of succession of future owners who are willing to take on the enforcement role. For example, the original declarant may sell off pieces of the development and step away from operating the development. The declaration should provide for enforcement by a logical successor to the declarant, such as the largest property owner. Another option is to provide for third-party professional management selected by a certain number of owners in the development,

with enforcement costs passed through as an operating expense. A declaration may even provide that successor property owners will have proportionate voting rights based on their ownership of parcels calculated on a square footage basis.

Enforcement by Multiple Parties

Similar enforcement issues occur if multiple REA parties are granted enforcement rights. Will every buyer of an REA party's property automatically step into the shoes of that party and gain enforcement rights upon acquisition? Perhaps the successor must agree to assume the obligations of an REA party before gaining enforcement rights. If an REA party's property is divided into more than one parcel, the REA drafter must consider which of those owners succeeds to the REA party's rights. Perhaps the owners of that property must appoint a single owner to become the REA party for the entire parcel rather than providing enforcement rights to all of the owners.

Sometimes subsequent owners do not want to be bothered with enforcing an REA. In that case, the subsequent owner deliberately elects not to succeed into the prior owner's role as an REA party and instead simply becomes subject to the REA without becoming an REA party. This leaves the other REA parties to handle enforcement duties.

Enforcement by or for Non-REA Parties Owners or tenants who are not REA parties may want an REA to be enforced even though they do not have the standing to do so themselves. For example, leases with tenants that have market power often require the landlord-REA party to pursue its remedies against a defaulting REA party upon notice from tenant that the landlord is in default under the lease. It is rarer for a non-REA party owner to be entitled to require an REA party to enforce an REA on its behalf, but supplemental two-party agreements are not unheard of. Typically, there must be a special circumstance to induce the REA party to assume that burden.

Tenants rarely have separate standing to enforce an REA. Sometimes landlords try to assign their REA enforcement rights to tenants, but a sophisticated tenant is likely to refuse on the grounds that the landlord's ability to enforce an REA on the tenant's behalf is part of the inducement for the tenant to execute the lease. Loan covenants may require a borrower-REA party to enforce an REA, and a lender can eventually become a direct enforcer if the borrower has defaulted and the lender takes over the obligation.

Types of Enforcement Rights

What are enforcement rights, and how does enforcement happen? These are good questions, as what sounds great in theory may not be in practice. In a simple REA, such as one providing cross access between two parcels, lien rights might be an effective enforcement mechanism if a party fails to pay for maintenance of a shared driveway. The amounts at issue simply may not be large enough to bring a collection action. However, the defaulting party will eventually want to refinance or sell the property and would have to make good on the debt to clear title.

An REA may provide for all rights and remedies at law or in equity, thereby permitting an REA party to pursue a restraining order on redevelopment. Perhaps a form of self-help would be available, such as the ability of a non-defaulting REA party to block an access road over its property that otherwise benefits the defaulting REA party.

One practical approach is for the REA to provide for rules and regulations that are enforced by the manager of the development, whether a third party or an owner. Then the manager can impose per diem charges or fines if those remedies have been agreed upon. Using unrecorded rules and regulations provides flexibility in enforcement while allowing operations to change over time. The rules and regulations should be reasonable and targeted to the main concerns of the parties from conception, as tenants in future leases will insist that regulations cannot be modified to reduce their rights or increase their obligations under their leases. This concept applies for future owners in the development – revising regulations to adversely impact property rights (or to appear to do so) creates strife and distractions in the development as the owners try to operate on their parcels.

Amendments and Consents

It is critical for the REA drafter to limit both the scope of, and number of people with, consent rights. As indicated above, this can be accomplished by establishing control zones and limiting the topics to which REA parties are entitled to grant or withhold consent.

If an REA must be amended, who has the right to approve the amendment? Traditionally each party had equal rights even if the amendment had zero effect on that party. Lenders also often have the right to approve REA amendments, particularly if a few owners control the development, as the lender may approve encumbrances on its collateral. Perhaps the best solution regarding amendments is to avoid the need to amend in the first place, saving amendments only for major redevelopments that affect the development's core, such as access throughout the development.

If written approvals or amendments cannot be avoided, how are approvals or consents obtained promptly and inexpensively? If REA parties drag their feet in providing consents, one option is to enter into unrecorded two-party agreements in which certain REA parties agree to execute an REA amendment that contains specific parameters. Lenders regularly accept these two-party agreements as evidence of consent among at least a percentage of REA parties, even if other REA parties are not cooperative. If an REA party refuses to enter into an REA amendment or two-party agreement and also does not exercise any of its available remedies for a violation of the REA, the party will presumably be estopped from asserting such violation after some period of time.

Interests of Others Affected by an REA The interests of non-REA-party owners or occupants must also be considered. For example, should a tenant leasing a small portion of a development burdened by an REA review the entire REA before signing its lease? The simple answer is "no." Instead, the prospective occupant who is not an REA party, but whose occupancy will be "subject to" an REA, should focus on a few issues that could affect its daily operations.

The first issue is to determine whether there are any use restrictions in the REA that either preclude an occupant's prospective use in the premises or impose onerous requirements. If that hurdle is overcome, the next question is whether there are restrictions on access or other restrictions that negatively affect the occupant's daily operations. Finally, the prospective occupant will want to investigate what monetary obligations the REA imposes and how those obligations are passed through to the occupant. The

prospective occupant will want to determine its proportionate share of taxes and operating expenses under the REA and the current amount of those expenses. With that knowledge in hand, the tenant can focus on negotiating a fair lease that truly acknowledges and addresses all of the REA obligations.

The prospective tenant may also try to negotiate some protection against inadvertent violations under the REA by asking the landlord to represent and warrant that the tenant's use does not violate the REA. Strong tenants might also consider requiring the landlord to pursue its REA remedies for violations on the tenant's behalf.

Conclusion

Drafting an REA for a new development is always a challenge, as is amending an existing REA. However, by thinking through and keeping what has worked in the past and discarding provisions that proved to be overreaching or prevented a development from adapting to new norms—such as frozen site plans, burdensome lists of prohibited uses, and provisions that give blanket approval and consent rights to parties who don't need them—the drafter of a modern REA can preserve the flexibility needed for the document to evolve in tandem with the development that it governs. n