

A Legal Perspective On NYC's Retail Real Estate Evolution

By **Andrea Gendel** (December 3, 2024)

As one of the world's most exciting and economically significant cities, New York City has always been a focal point for retail real estate. However, in recent years, the landscape has shifted dramatically due to various economic and social factors.

New York City's retail sector has faced unprecedented challenges in the past few years, particularly in the wake of the COVID-19 pandemic. Many brick-and-mortar stores struggled to adapt to social distancing measures and changes in criminal laws led to widespread shoplifting and organized theft, all leading to a wave of bankruptcies and store closures.



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Retail vacancies surged in the wake of the pandemic as many businesses were unable to sustain their operations. More recent high-profile closures in New York, including some locations of iconic establishments such as Bed Bath & Beyond, Lowe's, Vitamin Shoppe, Walgreens and Staples, among others, have left significant gaps, and in some cases, opportunities, in the urban retail landscape.

Despite these challenges, the NYC retail market is slowly showing signs of resilience.

In SoHo, two Chinese companies — Pop Mart, the toy seller, and Urban Revivo, a so-called fast fashion brand — just signed long-term leases under which they will open U.S. flagship stores in 2025.

Other hot retail corridors in Manhattan include the Flatiron District — Fifth Avenue mostly above 20th Street — the Meatpacking District, and high street locations such as Madison and Fifth Avenues.

These areas have robust residential neighborhoods as well as an influx of workers heading back to the office, even if only part time. As people return to their offices and consumers return to physical shopping in their residential and workplace neighborhoods, and as tourism continues to grow, landlords and retailers are exploring new leasing arrangements and flexible space solutions.

Traditionally, retail leases in NYC have been long-term commitments, often extending over 10 years or more. However, the pandemic caused a shift toward shorter-term leases and pop-up stores, allowing retailers to adapt quickly to changing market conditions and landlords to bring in cash flow while looking for a longer-term tenant.

Ikea and the Dutch fashion brand Scotch & Soda, for instance, opened pop-up stores in Manhattan in the second half of 2024 — both located in SoHo.

The legal implications of this type of change are profound and affect lease negotiations.

In short-term deals, it is important for a retailer to have as much flexibility as possible to build out its store in a short period with little landlord oversight.

Landlords should be cognizant of ensuring that a retailer does not make material or

structural changes to its space and that they timely return the space in the condition in which it was received, reasonable wear and tear excepted.

Particularly with a short-term deal, it is important for both parties to negotiate up front what a retailer envisions for the space with respect to alterations and operations so that both parties are on the same page.

All such provisions should be fleshed out in the term sheet to avoid any pitfalls. Preapproved plans for alterations are ideal, if possible, as delays in review and approval of plans, ability to obtain permits, and landlord objections to operation standards can be catastrophic to a retailer with a tight time frame to operate and market itself in the space.

For landlords, robust holdover provisions are particularly important if a longer-term, more permanent deal is to commence on the heels of the expiration of the pop-up or short-term deal. Landlords should also consider restricting any assignments or sublets, or prohibiting it entirely, to retain control of the space on deals that are for short periods.

From a legal standpoint, the increase in store closures and increased availability of retail space necessitates a reevaluation of standard lease agreements, and landlords and tenants must negotiate terms that reflect the new reality of retail.

It still seems to be a tenant market in most areas of the city, other than the popular corridors, and on longer-term deals, more generous tenant concession packages and flexible lease terms are common. Initial lease terms are shorter and have renewal provisions providing lock-step rental increases rather than based on rental fair market value.

Tenants are requesting broader use provisions, including experiential uses such as unique entertaining shopping experiences and cafes and food uses in a traditional retail store.

They are also requesting alternate rental structures, such as percentage rent and revenue shares, particularly during a retailer's business ramp-up stage, as well as longer free rent periods, increased tenant improvement allowances and flexible exit strategies like gross sales kickouts and termination rights.

All of this allows tenants to (1) move into markets that previously were either affordable or that did not have any vacancies that provided ample opportunity, and (2) broaden their traditional retail use and pivot if, in the future, a particular use is not working.

It probably goes without saying, but all of these particular provisions should be fleshed out in the term sheet and reviewed carefully to avoid disagreements and delays during lease negotiations.

While the COVID-19 pandemic prompted various government emergency measures directed toward social distancing and protecting tenants from financial hardship, some of which are no longer relevant, some tenants are taking the lessons learned from the experience and continue to request rent relief or deferments if they are unable to use their space as a result of governmental restrictions and certain force majeure events that affect use and operations.

This is sometimes heavily negotiated because, generally speaking, prior to COVID-19, force majeure events — such as a casualty, pandemic or governmental restriction on operations — did not typically excuse the payment of rent under a lease.

However, now that pandemic lockdown restrictions are in the rearview mirror, tourism is in recovery, and workers are returning to their offices at least a few days a week, many landlords are no longer willing to entertain such requests, particularly in the neighborhoods where vacancies are low.

That said, as the hot corridors continue to be leased up, tenant concessions may not be so generous in 2025, as the economic outlook seems cautiously optimistic; however, this remains to be seen as many landlords and tenants are anxiously awaiting the impact of President-elect Donald Trump's policies on the economy and on the New York City real estate market, generally.

In areas that are still plagued by vacancies, such as in Midtown, tenants will likely find better economic packages and will continue to have better negotiating power until the opportunities dry up.

The NYC retail real estate market is in a state of transformation, marked by recovery and adaptation to new consumer behaviors, the needs of retailers to have flexibility during this continued economic revitalization and the needs of landlords to retain and cultivate the vitalization of their real estate investments.

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Disclosure: The author represented Pop Mart and Urban Revivo in their leasing transactions discussed in this article.

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