

Crain's New York Business

Landlords and retailers are playing hardball with no end in sight

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National retailers hoping to bring [the city's commercial landlords](#) to the bargaining table by withholding rent during the pandemic are instead being taken to court.

Prime locations around Manhattan, where top brands such as [H&M](#), Gap and Brooks Brothers do brisk sales during good times, sit boarded up. Most of the [property owners haven't been paid](#) since March, and the debts are piling up.

"It's clear that retailers are taking advantage of the situation," said Menachem Kastner, the lawyer for JEMB Realty, H&M's Herald Square landlord.

Litigating these matters won't be easy and certainly won't be quick, real estate attorney Howard Kingsley said. For now, he said, evictions are blocked, though once the moratorium is lifted, it could take many months for the courts to plow through the backlog of cases and get people in front of a judge.

Retailers know this, and they will try to use this as a negotiating tactic to cut a deal with their landlords, said David Firestein, a partner at retail brokerage The Shopping Center Group.

For retailers, litigation is a last resort, said Leon Buck, the vice president of banking and financial services at the National Retail Federation. "We always prefer negotiation over litigation."

Since May, eight international brands were named in Manhattan lawsuits: Gap, H&M, Brooks Brothers, Victoria's Secret, Valentino, Bath & Body Works, Foot Locker and Urban Outfitters. Four of them are being sued at their locations in Herald Square, which appears to be a hot spot for rent default, thanks to its steep rents.

The 34th Street location led retail activity in the city—30,000 square feet leased across eight transactions—during the first quarter, according to a CBRE report. Yet the pandemic has had a perilous impact on the retail

industry, spurring layoffs and bankruptcies nationwide. Clothing stores in the city lost 64% of their workers, according to data from the Department of Labor.

"If there's no revenue coming into a store, how can you pay rent?" Buck said. "All the commercial renters wanted was rent relief or rent abatement for those months that they had to close because of the pandemic."

Only a handful of big-box brands, such as Target, Walmart and Lowe's, were allowed to stay open during the closures; those selling nonessential goods, such as clothing and makeup, were ordered to stay shut.

"Shopping for apparel in physical stores will look nothing like what was contemplated by the lease when it was executed," Gap attorney Joshua Epstein said in a complaint.

L Brands beat SL Green, the city's largest commercial landlord, to the punch when it sued for holding their stores—Victoria's Secret and Bath & Body Works—in default of their rent. Victoria's Secret's enormous Herald Square location comes with a minimum monthly price tag of nearly \$1 million, and it is two months behind on rent. Bath & Body Works, which has been at its 304 Park Ave. S. location since 1996, owes SL Green about \$127,000 for the two months it has yet to pay for.

Both are looking to terminate their leases permanently, claiming the space is unusable under a legal argument called "frustration of purpose."

SL Green said it had made several attempts to reach an agreement with Victoria's Secret, which also has a burgeoning online presence, to defer a portion of the rent.

"Instead, this large national, publicly traded conglomerate is exploiting the current health and economic crisis for its own financial gain rather than honor its contractual rent obligations," said SL Green's lawyer, Stephen Meister.

Lawyers for L Brands could not be reached for comment.

While e-commerce has become popular under stay-at-home orders, online sales are unlikely to erase the losses from not having foot traffic, the National Retail Federation's Buck said.

"Selling ladies underwear is not the same as selling groceries. There's no way their online sales are the same as people walking into the store," he said.

Kingsley said he didn't think the frustration-of-purpose argument would hold up in court. It is a negotiating tool, he explained, that retailers and other businesses have used to get relief, such as rent deferrals or partial payments, from landlords.

"Tenants are throwing around frustration without really knowing the case law," said Kastner, JEMB's lawyer. "In 1918, when you had the Spanish flu, frustration of purpose didn't fly then either."

At this point tenants should expect disasters such as this to happen, and the proof is in the leases that already include language for pandemics or plagues, he said.

If the courts were to acknowledge the lease termination based on that principle, they would run the risk of undermining landlords' ability to make deals with retailers in the future, said Firestein, the Gap's attorney. If banks see that leases can be easily broken, they won't give landlords financing, he said.

Some leases, such as Victoria's Secret's, include a percentage rate rent clause. On top of Victoria's Secret's base rent of \$938,000, the lingerie brand pays SL Green between 4% and 5% of its gross annual sales at that location, which could be as high as \$50 million.

If Victoria's Secret abandons ship, SL Green can kiss goodbye an additional \$2 million per year just in percentage rate fees.

Right now, retailers aren't meeting their sales targets anyway.

"I do think the retail industry will bounce back and be resilient," Buck said, "but it will be years."