

COMMERCIAL LEASE NEGOTIATIONS – A FINE BALANCE

The global economic recession has adversely affected several areas and commercial leasing has been no exception. In our February 2009 Commercial Real Estate Law Alert we explored certain commercial lease default issues. In this Alert, we identify certain lease provisions that may be subject to greater negotiation during these challenging times.

Until recently, the Canadian leasing market generally favoured landlords. Now, we may witness a shift towards a greater equilibrium with certain credit-worthy tenants enjoying increased negotiating leverage. Landlords who are receptive to tenant requests may potentially realize: (1) negotiation cost savings; (2) improved tenant relations; and (3) a competitive advantage over other landlords. Landlords will need to strike a fine balance, however, between accommodating tenant requests and ensuring they can promptly and effectively deal with problematic tenant issues.

NEGOTIATING AN EVEN-HANDED LEASE ...

Operating Costs

Money matters, especially in recessionary times. Even in the best of economic times, operating cost provisions are scrutinized. We anticipate that operating costs will continue to be intensely negotiated. Landlords will likely enjoy negotiation cost savings and goodwill if their leases include reasonable operating cost exclusions. We outline below some commonly requested operating cost exclusions:

- a. expenses resulting from the landlord's negligence;
- b. costs related to environmental laws, except to the extent the tenant is responsible;
- c. income and business taxes of the landlord; and
- d. costs covered by insurance.

Non-Disturbance and Subordination

Generally, landlords' standard form leases require tenants to attorn, and subordinate their leasehold interests, to the landlords' lenders. In return, tenants will likely want to receive a non-disturbance agreement from the landlord's lender. Although a landlord might well resist agreeing unconditionally to obtain a non-disturbance agreement from a lender, a landlord may agree to use reasonable efforts (or reasonable commercial efforts) to seek to obtain a non-disturbance agreement from the lender in the tenant's favour. Understandably, a tenant will want to receive a contractual assurance from the landlord's lender not to "disturb" the tenant's possession of the leased premises, if the tenant is not in default.



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Lease Registration

Tenants will often want to register either their lease or a "short form" lease or notice of lease on title to alert third parties to the tenant's leasehold interest in the landlord's lands. Landlords may resist the lease registration request, particularly if there are several tenants who wish to register their leases. Yet, this is one instance where a balance could fairly readily be achieved. The landlord and tenant could agree that the tenant may register a "short form" lease only or notice of lease, at the tenant's cost and subject to the landlord's approval, and the tenant's further promise to delete the registration from title at the end of the term.

Relocation and Demolition Clauses

A landlord may want the right to relocate a tenant to different premises. While a landlord wants flexibility, a tenant wants certainty (or, at the very least, the least possible disruption to its business and comfort that the landlord will bear all costs associated with the relocation).

Similarly, a landlord may want the right to terminate the lease if the landlord plans to demolish or remodel the leased premises. Once again, while a landlord wants to keep its options open, a tenant wants to be able to plan its future without these contingent risks.

... WHILE REMAINING GUARDED

Continuous Operation

While a landlord will want a tenant continuously to operate (especially in a retail centre), a tenant may want the right to "go dark". Clearly, these are irreconcilable positions.

Even if a lease contains a continuous operation covenant, a court may ultimately be unwilling to force a tenant to reopen its business. So, a landlord may want to include a specific remedy for a breach of the continuous operation covenant (e.g., a daily rental increase until the tenant reopens) that would be easier for a court to enforce than requiring the tenant to carry on a money losing business.

If a landlord were to agree to permit a tenant to "go dark", the landlord would need to ensure that this is not prohibited by any other lease to which the landlord is a party. The landlord would also need carefully to consider the potential "domino effect" where multiple tenants have "go dark" rights, especially in a retail centre.

Default Clause

It would be prudent for landlords to revisit their standard form leases and to confirm that the default and remedies provisions are fulsome. For instance, landlords will want to have the greatest possible range of remedies, including the following:

- a. to re-enter the premises and terminate the lease;
- b. to distrain;
- c. to relet the premises on the tenant's account;
- d. to commence an action for the amounts due and recover costs; and
- e. to perform the tenant's covenants and recover costs.

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Meanwhile, tenants will want to have:

- a. a limited list of defaults;
- b. notice of defaults; and
- c. opportunities to cure defaults.

In these recessionary times, landlords may well refuse to limit the list of defaults, tighten the notice period for defaults and circumscribe a tenant's opportunity to cure a default. Regardless, there will invariably be certain defaults that will automatically be events of default permitting a landlord to seek to exercise its remedies (e.g., if the tenant is insolvent or becomes bankrupt).

Loss of Rights

It is improbable that landlords will permit tenants to exercise certain rights if the tenants are in default. These rights could include the following:

- a. options to renew;
- b. future rent free periods; and
- c. assignment or subletting.

When negotiating the lease, tenants will need realistically to assess whether there are certain "non-negotiable" provisions and those we note immediately above will probably fall in that category. However, a tenant may be able to successfully negotiate that these rights are barred only by current tenant default, and that a past, cured default is not a bar to exercising these rights.

Security Deposits

Typically, landlords require security deposits. Increasingly, landlords may wish instead to receive letters of credit (preferably in support of a "stand alone" indemnity from a third party). It is beyond the scope of this Alert to examine in any detail the potential advantages of letters of credit so we invite you to contact us to discuss this further.

Indemnity

Given the current economic upheaval, landlords should consider whether there is a credit-worthy third party from whom the landlord can receive a "stand alone" indemnity. Ideally, the indemnity would be unlimited both in duration and dollar amount. Again, it is beyond the scope of this Alert to examine in any detail the potential advantages of a "stand alone" indemnity so we invite you to contact us to discuss this further.

CONCLUSION

This Alert is provided as a general overview. Readers are encouraged to obtain legal advice before implementing any of the steps or strategies set forth in this Alert. If you have any questions or concerns relating to commercial tenancy matters, we encourage you to contact any member of our **Real Estate Group**.

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