

Real Estate Law Bulletin

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Rooftop Solar Leases – Knowledge is Power

By Lloyd Cornett



In May of 2009, the Ontario legislature passed the *Green Energy Act, 2009* (the “Act”) as part of the province’s plan to become a leading sustainable energy economy and to provide incentives for the development of renewable clean energy sources such as wind, solar, hydro and bio-fuel while at the same time advancing the government’s agenda to eliminate coal from the energy supply mix and to create new employment opportunities for Ontarians. One of the key features of the Act, in addition to facilitating and expediting the approval process for renewable energy projects, is the introduction of the Feed-in Tariff (“FIT”) program, offered through the Ontario Power Authority (“OPA”), pursuant to which renewable energy developers will receive a set revenue stream for a fixed period according to the type and volume of energy produced. The FIT program has spawned tremendous interest in rooftop solar projects, both small and large scale. In addition to nearly 1,200 applications for small “microFIT” installations, between October 1, 2009, when the program was launched, and December 1, 2009, the OPA received about 1,000 applications for projects over 10 kilowatts – more than enough to deliver the 2,500 megawatts of renewable energy earmarked for the first round of the FIT program.

Anyone who has flown into Pearson International Airport can readily grasp the potential – from your aircraft window you are offered a view of thousands of flat rooftops on warehouses, industrial plants, shopping centres, office buildings, hotels, hospitals and schools – and the race is on to secure leases for the best locations in the Greater Toronto Area and across the province. Aird & Berlis LLP is privileged to represent many property owners with suitable rooftops and several of the companies which are seeking to enter into lease agreements with owners to erect rooftop solar photovoltaic (“PV”) arrays on their buildings.

In this article, we will briefly look at some of the considerations which should be taken into account by landlords and rooftop solar providers in deciding whether to pursue a rooftop solar lease and, if a decision is made to enter into a lease, some of the issues which are particularly important to address in the lease documents.

Preliminary Considerations

Not every rooftop will be suitable. In addition to being flat and relatively free of obstructions, the rooftop needs to be exposed to the sun (unshaded by other structures or potential future structures on the building site or on neighbouring properties) and physically capable of supporting the weight of a PV array. Size also matters. The ideal size for a solar PV rooftop installation is in the range of 30,000 to 100,000 square feet. A new or recently rebuilt roof is preferred, because it is more likely to not require additional structural support to accommodate the array, and because it will be less likely to require significant repair or replacement during the operating period of the solar project, which might necessitate the temporary removal or relocation of the solar array. The building owner must also have control over the rooftop. That is, the rooftop must not be subject to existing leases to tenants or other legal restrictions which may prevent the landlord from being able to grant exclusive rights to the operator.

An owner should also consider its future plans for the building. Once an application is approved by the OPA, the applicant must sign a power purchase agreement (“PPA”) with the OPA for a term of 20 years. Accordingly (and subject to incorporating terms into the lease which address early termination and compensation to the solar project operator) the owner needs to be satisfied that there is little likelihood of significant alteration to the building which might have an impact on the operator’s use of the rooftop area during that period. An important aspect of the PPA is the transfer to the OPA of all of the environmental attributes associated with the project. While there is not yet a developed market for carbon credits and renewable energy credits, it can be expected that such a market will eventually evolve and a building owner which has leased its rooftop to an operator under the FIT program will not be eligible for any credits relating to the rooftop solar facility, and neither will the operator. Any such credits will belong to the OPA.

A building owner should also consider whether it should develop its own solar rooftop facility, rather than lease the rooftop to others for such purpose. While the cost today of installing a rooftop solar power facility is high, and many owners will not want to make the investment necessary to participate directly in the FIT program, if the cost of electricity rises in the future, which seems very likely, and the cost of solar panels and associated technology declines, which also seems likely, there may be a point at which it makes economic sense for a building owner to itself install a solar system to either generate electricity under the FIT program or to produce electricity for consumption within the building and preserve the ability to claim the environmental credits which may at some point become available and valuable. Another alternative being offered by some solar project developers to building owners is the opportunity to enter into a joint venture arrangement wherein the owner invests in the project and participates in the revenue generated.

Issues Concerning Rooftop Leases

If a building owner and a solar project developer conclude that a rooftop lease is feasible and preferred, they will need to properly address a number of issues in their lease agreements, some of which are:

- **Option Agreement** – Most rooftop solar developers require an option to lease the rooftop space. The option will permit the operator to have access to inspect and test the rooftop and do such other investigations as it deems necessary to satisfy itself that the location is suitable for a solar PV array and that the building owner is in a position to grant a lease to it. The option will be open for exercise by the operator for a period sufficient to enable the operator to conduct such inspections and investigations and to apply for and obtain a FIT program approval and enter into a PPA with the OPA. The option agreement will provide that if the developer exercises its option, the parties will enter into a lease of the rooftop area on the terms set out in the option agreement.
- **Tenant Covenant** – As with any lease, it is advisable for the landlord to consider the financial strength and “track record” of the tenant, and to determine whether a deposit or other form of financial security should be sought to protect the landlord from the consequences of a tenant default.
- **Term and Rent** – The term of the lease must be at least 20 years (to match the term of the FIT program agreement with the OPA) and may or may not provide for renewal rights. Renewal rights are potentially important, as it is anticipated that the productive life of the solar PV array equipment may be substantially longer than 20 years. Rent can be structured in several ways. Usually, it will be a fixed, all-inclusive “gross” rent, but it may be calculated based on the square foot area of the portion of the rooftop utilized, the wattage produced by the facility, or on some other basis. In addition, the lease may provide for the tenant to pay for its electricity consumption and for any realty taxes associated with the solar PV array.
- **Access** – The tenant will require access 24/7 to install, maintain, repair and replace its equipment.
- **Roof Repair** – The lease will need to address the necessity for roof repairs and replacement. Issues such as notice to the tenant, the period to do the work, relocation of the solar PV equipment while the repairs or replacement are undertaken, and compensation to the tenant for lost revenue during repair/replacement will be of concern.
- **Plans and Specifications** – The landlord will want approval rights over the tenant’s plans and specification for the original installation and for any subsequent alterations, repairs and replacements. The tenant will want to ensure that such approval is not unreasonably withheld or delayed.
- **Ownership** – It will be critically important to the tenant, for financing purposes, that its facilities are never treated as building fixtures (i.e. they will not be part of the building and therefore will not be the landlord’s property) but instead are always the sole property of the tenant. The tenant will also require that the landlord waive any rights of distress or other rights to claim a lien or other interest in the tenant’s equipment, in order to facilitate such tenant financing.
- **Financing** – In order to obtain financing for its equipment, the tenant may need to assign the lease as collateral

security to its lender, and will need the landlord to agree to enter into an agreement with the tenant's lender enabling the lender to cure any default by the tenant under the lease and to obtain a new lease on the same terms if the lease is terminated without the lender's consent (e.g. as a result of the bankruptcy of the tenant). The landlord will want the lender to agree that any monetary or other curable default must be cured prior to the new lease being granted.

- **Insurance** – The landlord will want the tenant to obtain and maintain insurance on its facilities, and adequate liability insurance, and the tenant will similarly want the landlord to obtain and maintain insurance on its building as well as public liability insurance. Appropriate releases, waivers and indemnities will also be important to both parties.
- **Interference** – As noted above, it will be extremely important to the tenant that nothing happens which blocks or otherwise interferes with sunlight reaching its solar PV array. Consequently, it will require covenants from the landlord that it will not take or permit any action which would have such effect. In addition to the normal termination for damage and destruction provisions found in a typical lease, if at some point something happens (such as the construction of a building in the vicinity) which impairs the availability of sunlight or otherwise prevents the tenant from operating its facility, the lease will need to address the tenant's rights to terminate the lease in such circumstances.
- **Non-Disturbance** – As would be the case for any lease, the tenant may require that the landlord obtain agreements from each of its mortgage lenders to the effect that the lender will permit the tenant to remain in possession of the leased rooftop, etc. notwithstanding any default by the landlord under the mortgage, and will agree to recognize the lease and the tenant's rights.
- **Repair and Maintenance** – Each party will want to ensure that proper repair and maintenance obligations are included in the lease. The landlord will want the tenant to properly maintain and repair its equipment to ensure it is kept safe and in compliance with laws and regulations, and the tenant will want the landlord to take adequate care of the building, especially the roof, to avoid any impairment of the tenant's ability to properly operate its solar facility. Snow removal and disposal may also need to be addressed, although it is interesting to note that in southern Ontario at least this is not considered to be a significant problem and, due to the shading effect of the solar panels on the rooftop, there may be a benefit to the building in the form of reduced energy costs and extension of the useful life of the roof due to the protection from the elements afforded by the existence of the solar array.
- **Registration on Title** – In order to obtain financing and to protect its interest in the event of a subsequent sale, mortgage or other disposition of the landlord's interest in the building, the tenant will want the right to be able to register a notice of its lease on title to the landlord's property. The landlord will want the tenant to agree that it will "attorn to" (recognize as the landlord under the lease) its mortgagee (if it goes into possession due to a mortgage default) and any purchaser of the property.

Conclusions

Rooftop solar PV arrays are soon going to become very common, and while not all rooftops will be suitable and not all building owners will be willing to commit to lease their roofs for a twenty-year period, with a little forethought and careful attention, rooftop solar leases can potentially be a win-win for both building owners and solar project developers.

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