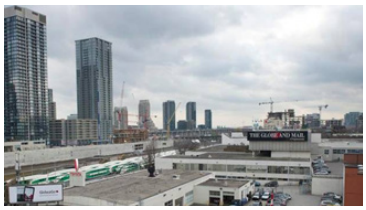
AIRD & BERLIS LLP
Barristers and Solicitors

Real Estate Law

In this Issue:

Big Deals

In Phase I of ALLIED REIT's QRC West (Queen Richmond Centre) project, A&B represented ALLIED REIT in a 10-year lease of 50,000 square feet of office space to Sapient Corporation for its Toronto office. The lease will commence upon completion of construction which is anticipated to be March 2015.



A&B represented Woodbridge Investments Inc. on the sale of a 6.5 acre site at Front Street West and Spadina Avenue for $136-million to RioCan Real Estate Investment Trust, Allied Properties Real Estate Investment Trust and Diamond Corp.

A&B represented IBM Canada Limited in a site selection process and purchase of vacant lands in the City of Barrie for development of a new state-of-the-art data centre for IBM's use. The $90 million data centre opened in September 2012.

A&B represented Skyline Commercial REIT in its acquisition of a $120 million commercial portfolio from Conundrum Industrial Property Fund. The purchase is the first phase of a scheduled two phase acquisition of 60 properties comprising nearly 2.4 million square feet of commercial space located in nine different Ontario cities, for an aggregate purchase price of $242 million.

Mixed Use Developments and Strata Title

By Michael Brooks and Vedran Simkic*

Mixed use development is on the rise in North America and includes a variety of significant considerations.

One important consideration relates to non-condominium strata title developments. In these developments, positive obligations do not run with the land and are only enforceable in contract against subsequent owners. Furthermore, lawyers need to construct a regime of permitted transfers, rights of first refusal to purchase adjoining lands, and mandatory assumption agreements to make sure that owners of a strata title mixed use project always have privity of contract with their vertical or horizontal neighbours in the same project.

A further consideration is the significance of a cost sharing agreement. This agreement specifies, prior to commencement of construction, who will be responsible for what cost, both hard and soft, in the development and construction of a mixed use, mixed owner project. A well-drafted cost sharing agreement can minimize the chance of future disputes.

Lastly, it is typical in most mixed use projects to have a shared services or reciprocal operating agreement post construction. This agreement will potentially set out the following in detail:

- responsibility for maintenance repairs and replacements for any common areas;
- requirements for joint building insurance;
- individual insurance for each owner's premises;
- the right of first refusal to purchase an adjoining owner's interest if it is put on the market;
- restrictions on street level and building top signage that may be installed;
- the creation of an insurance trustee regime for major damage that might occur;
- a governance process setting out regular meetings; and
- the creation of an annual budget for shared facilities and common area maintenance repair and replacement costs.

In addition to the foregoing, when each owner has their own separate financing to arrange, matters can get complicated as each lender will wish to review all major agreements.

Mixed use developments are complicated but workable, and can result in great profitability.

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Landlord Consent is Required to Overhold

By Lloyd Cornett and Michael Ventresca

Introduction

Landlords and tenants often seek advice on what happens when the tenant wishes to remain in the leased premises after the lease term expires, but the parties have not extended or renewed the lease. At law, there is an implied obligation that the tenant must vacate the leased premises when the lease term expires. If the tenant remains in the leased premises after the lease term expires without the landlord's consent, the tenant is generally considered a trespasser. If the tenant remains in the leased premises after the lease term expires with the landlord's consent, a new tenancy is deemed to arise. The term of such new deemed tenancy is either month-to-month (if the expired

lease term was less than one year) or year-to-year (if the expired lease term was one year or more), unless the parties have agreed otherwise.

Overholding Clauses

In order to avoid a year-to-year tenancy arising after a lease term expires (which year-to-year tenancy may only be terminated on six months' notice), commercial leases typically contain an overholding clause. Such clauses set out the terms and conditions for the tenant to remain in the leased premises beyond the term, including the term of the overholding tenancy (e.g. month-to-month), the amount of rent payable, and the procedure to terminate the overholding tenancy. Overholding clauses may also state that the landlord's consent is required before the tenant can overhold.

If the overholding clause is silent on landlord consent, it may appear from the clause's wording that the tenant has a unilateral right to remain in the leased space after the expiry of the term. This was argued by the tenant in *AIM Health Group Inc. v. 40 Finchgate Limited Partnership*, 2012 ONCA 795, http://canlii.ca/t/fttft (the "**AIM case**"). In this case, the Ontario Court of Appeal ultimately rejected the tenant's interpretation and held that a landlord must consent to an overholding, regardless of whether the overholding clause specifically requires it.

Landlord Consent is Required to Overhold

In the AIM case, the lease between the landlord and tenant was set to expire on December 31, 2011. Several months prior to expiry, the tenant notified the landlord that it would not exercise its option to renew the lease, but it wished to remain in the leased premises for some time beyond expiry. The landlord did not agree to such overholding and instead sought a new tenant. On December 19, 2011, the landlord advised the tenant that a new tenant had been secured and vacant possession of the leased premises was required on expiry of the term. The tenant continued to occupy the premises after the term expired and, on January 1, 2012, the landlord changed the locks. On January 6, the tenant obtained a declaration that it was entitled to re-enter the leased premises pursuant to the overholding clause, which provided in part:

> If, at the expiration of the initial Term or any subsequent Term or any subsequent renewal or extension thereof, the Tenant shall continue to occupy the Leased Premises without further written agreement, there shall be no tacit renewal of this Lease, and the tenancy of the Tenant thereafter shall be from month to month only and may be terminated by either party on one month's notice. […]

The tenant interpreted the overholding clause as providing the tenant with the unilateral right to remain in the leased premises beyond the term. The landlord appealed.

The majority of the Court of Appeal agreed with the landlord, stating that "for an overholding tenancy to arise, the landlord must agree that the tenant may stay in the premises, which agreement is normally evidenced by the landlord's acceptance of rent." Such requirement for landlord consent is implied where the overholding clause is silent. The dissenting judge had a different view, stating that if landlord consent was a necessary precondition to the tenant remaining in the leased premises after expiry of the term, the lease should have been drafted so as to specifically require landlord consent.

Conclusion

The take-home message from the AIM case is that the landlord's consent is necessary for the tenant to remain in the leased premises after expiry of the term, even if the overholding clause does not specifically require it. Acceptance of rent by the landlord will be evidence of consent.

Landlords and tenants should carefully review the overholding clauses in their leases to ensure such clauses accord with their intentions. The clauses should address the term of overholding, the amount of rent payable, how the overholding tenancy is terminated, and whether the tenant has a unilateral right to overhold. On the latter issue, the result in the AIM case means that if a tenant wishes to have the unilateral right to overhold after the lease term expires, the overholding clause must be drafted to specifically provide such right. For their part, landlords must be aware that merely accepting rent from a tenant after the term expires, and nothing more, may be sufficient evidence that the landlord consented to an overholding.

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Drafting an Effective Lease Indemnity Agreement

By
Lloyd Cornett

When negotiating a lease, a landlord may require that the tenant provide security for the performance of the tenant's obligations under the lease. Such security will typically be in the form of a cash deposit, a letter of credit, a guarantee or indemnity from a third party, or a combination of the foregoing. This article will address lease indemnity agreements and why landlords prefer them over lease guarantee agreements, and some minimum requirements to ensure that an indemnity agreement is drafted so that it is legally effective.

The principal reason that landlords prefer lease indemnity agreements over lease guarantees stems from the difference in liability between an indemnifier and a guarantor. An indemnifier assumes a primary liability, independent of the tenant, whereas a guarantor assumes only a secondary liability. The following explanation taken from an often-cited Canadian case[1] succinctly describes this difference.

> "In its widest sense a contract of indemnity includes a contract of guarantee. But, in the more precise sense…a contract of indemnity differs from a guarantee. An indemnity is a contract by one party to keep the other harmless against loss, but a contract of guarantee is a contract to answer for the debt, default or miscarriage of another who is primarily liable to the promisee."

Therefore, a landlord may pursue an action against an indemnifier immediately upon default by the tenant, but must first pursue an action against the tenant before seeking recourse against a guarantor.

A secondary explanation for the preference for indemnities can be found in Canadian jurisprudence related to the effect of the bankruptcy of a tenant upon the obligations of a guarantor or an indemnifier. Until a 2004 decision of the Supreme Court of Canada[2], it was generally accepted law that upon the bankruptcy of a tenant, all of the tenant's rights and obligations under the lease, including its obligation to pay rent, passed to the trustee in bankruptcy. Accordingly, there were no lease covenants which the tenant was liable to perform and therefore a guarantor's guarantee of the due performance by the tenant of its covenants under the lease became inoperative. While the Supreme Court of Canada decision is understood to have reversed the previous law and provides reassurance as to the enforceability of guarantees in bankruptcy situations, indemnities are still generally regarded as preferable security by most landlords.

In order to ensure that a lease indemnity agreement will be enforceable, several legal requirements must be met. Firstly, and perhaps most importantly, there must be "consideration". Consideration is "some right, interest, profit or benefit accruing to the one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other."[3] Many lease indemnity agreements provide that the consideration given by the landlord to the indemnifier for the indemnity is the landlord's entering into the lease with the tenant. However, it would be advisable for the landlord not to rely solely upon such consideration, but to provide as a minimum, some minimal monetary consideration. If consideration cannot be shown to have passed from the landlord to the indemnifier, the indemnity agreement may not be enforceable.

Certain other clauses should be contained in every lease indemnity agreement. These would include:

- a promise by the indemnifier to perform the obligations of the tenant under the lease, regardless of tenant compliance with or default of its covenants contained in the lease
- confirmation that the obligations of the indemnifier include both the obligation to make all payments of rent and the obligation to perform all other covenants of the tenant under the lease
- a covenant that the indemnifier and the tenant shall be jointly and severally liable under the lease
- an acknowledgement that the indemnifier will be liable for all losses, costs or damages resulting from the tenant's default or the disclaimer of the lease under any statute (e.g. bankruptcy laws)

1 Pearce L.J. in Yeoman Credit Ltd. v. Latter, [1961] 2 All E.R. 294 (C.A.) at 296 cited by Stratten J. in Canadian General Insurance Co. v. Dube Ready-Mix Ltd. [1984] N.B.J. No. 50 (C.A.) at para 7.

2 Crystalline Investments Ltd. v. Domgroup Ltd. [2004] 1 S.C.R. 60

3 Currie v. Mesa (1875), L.R. 10 Exch.153 at 162

- a covenant by the indemnifier that if the lease is terminated due to the tenant's default, or disclaimed as a result of the tenant's bankruptcy or other insolvency, the indemnifier may be required to enter into a new lease with the landlord on the same terms as the lease with the tenant for what would have been the balance of the lease term remaining, but for the tenant's default or such disclaimer

Many additional clauses are typically found in lease indemnity agreements, and should be carefully considered when drafting the agreement. While perhaps not strictly required for the agreement to be effective, such clauses often clarify or expand the scope of the indemnity, or waive potential defenses which the indemnifier may seek to assert if called upon to honour its obligations under the indemnity.

There are pitfalls which may result in a lease indemnity agreement being found by a court to be unenforceable. While it is beyond the scope of this article to canvass all of them, an example would be a material amendment to the lease agreement agreed to by the tenant and the landlord which, if not consented to by the indemnifier, may result in the release of the indemnifier from its obligations despite language in the indemnity agreement to the contrary.

Another potential pitfall is the limitation period for seeking recovery on an indemnity agreement. Under the *Limitations Act*, 2002 (Ontario), no proceeding can be commenced in respect of a claim except within a period of two years after the claim is discovered[4]. Accordingly, a landlord may find itself unable to enforce a claim against an indemnifier under a lease indemnity if it does not commence an action in court to assert such claim within two years after the landlord "discovered" (i.e. became aware, or should have become aware) that it had a claim against the indemnifier.

Conclusion

A lease indemnity agreement can constitute valuable security for a landlord to ensure that a tenant will perform its obligations under a lease. Care must be taken in the drafting of such agreements, and in their enforcement, so that they will be effective to provide the landlord with the security it requires.

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4 *Limitations Act, 2002*. C.24 Sched.B., s.4

Toronto's Student Residence Shortage and the Challenges Associated with Solving it

By Michael Brooks and Aaron Silver*

With three large universities and numerous colleges located in the City of Toronto (the "**City**") and a dearth of student residences to provide accommodation, the demand for student residence rooms appears to be perpetually high. Private developers have begun to step in, in an attempt to fill this void. However, there are several issues, aside from proper zoning, a private developer must consider before setting out to construct such a building.

The most problematic aspect of a private student residence is the ambiguity of its classification. Would the residence be considered a "rooming house" and therefore be subject to the rules and regulations of Chapter 285 of the Toronto Municipal Code (the "**Code**") related to "rooming houses," or is a residence treated like any other apartment building? The answer lies in the floor plans.

A "rooming house" is defined in §285-7 of the Code as "a building that contains dwelling rooms." "Dwelling room" is defined as "a room used or designed for human habitation and may include either but not both culinary or sanitary conveniences." It would appear that any residence built containing both a washroom and kitchen within each student room would not be deemed a "rooming house." This is significant because any building categorized as a rooming house requires a license. The Code currently restricts licensed rooming houses to a maximum of 25 units.

A second issue facing prospective residence owners is rent control. Private student residences do not enjoy the exemption from rent control regulations contained within subsection 5(g) of the *Residential Tenancies Act*, 2006 S.O. 2006, c. 17. Only student residences provided by "educational institutions" are exempt.

One final important consideration is whether it is permissible to discriminate against prospective tenants based upon their designation as a student. Subsection 2(1)

of the *Human Rights Code* R.S.O. 1990, c. 19 sets out that "Every person has a right to equal treatment with respect to the occupancy of accommodation, without discrimination because of race, ancestry, place of origin, colour, ethnic origin, citizenship, creed, sex, sexual orientation, gender identity, gender expression, age, marital status, family status, disability or the receipt of public assistance." Discrimination based on a person's enrolment in college or university does not run afoul of any of the enumerated grounds and is therefore seemingly permissible.

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Case Comment: *Antrim Truck Centre Ltd. v Ontario (Transportation)* Disney-Pixar's Cars Plays Out in the Supreme Court of Canada

By Derek McCallum and Aaron Silver*

Facts

In the Oscar-nominated Disney-Pixar feature *Cars*, the fictional town of Radiator Springs, formerly a popular stopover spot along U.S. Route 66, was financially devastated by the construction of Interstate 40 which bypassed the town. The Supreme Court of Canada considered a case with eerily similar facts. In *Antrim Truck Centre Ltd. v. Ontario (Transportation)*, 2013 SCC 13, the Province of Ontario (the "**Province**") created an extension of a section of Highway 417. The extension crippled the appellant's truck stop business as it rendered Highway 17 obsolete. The truck stop owner sought damages for injurious affection, which may be sought even where no land is expropriated but where "the lawful activities of a statutory authority on one piece of land interfere with the use or enjoyment of another property."

Decision

Justice Cromwell held that the truck stop was entitled to damages for injurious affection. He found that all three statutory requirements to recover damages for injurious affection under the *Expropriations Act* were met: (i) the damage resulted from action taken under statutory authority; (ii) the action would give rise to liability but for the statutory authority; and, (iii) the damage resulted from the construction and not use of the works. The second requirement, which was the only one in dispute, was met because the truck stop owner would have been entitled to damages for private nuisance. Private nuisance can be established if the interference with one's property is substantial and unreasonable and could not reasonably be expected to be borne by the owner without compensation. Whether the nature of the defendant's conduct is unreasonable is irrelevant to the analysis.

Implications

It would appear on the surface that, just as every fairy tale ends, the residents of Radiator Springs as well as the truck stop owner on Highway 17 lived happily ever after. However, this case may have negative consequences on future infrastructure projects. When considering whether to undertake necessary infrastructure projects, the Province as well as municipalities may be forced to delay or scrap the projects altogether for fear of injurious affection lawsuits.

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Case Comment: *Oro-Medonte (Township) v. Warkentin*, 2013 ONSC 1416

By Aaron Silver*

Facts

An irregularly-shaped piece of land within a large plan of subdivision, named Lake Shore Promenade (the "**Promenade**"), was dedicated to the Township of Oro (the "**Township**") in 1914. Over the years following the dedication, neighbouring property owners built private structures on the Promenade, with the Township's full awareness. The Township brought an action seeking a declaration by the court that the Promenade is municipally owned. The landowners sought ownership of parts of the Promenade by reason of long-time possession.

Decision

Justice Howden of the Ontario Superior Court of Justice held that the dedicated land is owned by the Township. The Court rejected the landowners' adverse possession claim. Justice Howden explained that "land acquired by a municipality and used for public purposes is held in trust for the benefit of the public and cannot be lost, or the municipality's title extinguished, by reason of ordinary acts or omissions within the meaning of the law of adverse possession." This conclusion was reached despite the Township not having exhibited any consistent responsibility toward the use of the land. However, the Court found that longstanding private structures could likely be retained. Because the structures have been in place on parts of the Promenade for decades and the Township, knowing of their existence, never asserted its rights as owner, the Township was found to have acquiesced to their continuance.

Implications

Justice Howden clarified the law in relation to possessory title in determining that under no circumstances can landowners successfully initiate a claim of adverse possession of municipally owned land. Caution should be exercised by landowners to ensure structures are not built on municipally dedicated lands due to a municipality's ability to successfully found an ownership claim in the land decades, or even centuries, later.

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Single-Purpose Corporations and Real Estate Development: What to do if a Deal Falls Apart

By Michael Ventresca

Overview

On October 17, 2012, the Supreme Court of Canada released a decision with significant consequences for real estate developers using single-purpose corporations. Such corporations are commonly created for the sole purpose of purchasing and developing a property. In *Southcott Estates Inc. v. Toronto Catholic District School Board*, 2012 SCC 51, the Supreme Court of Canada, by a 6-1 majority, makes it clear that if a deal goes sour, a single-purpose corporation has a duty to mitigate its losses by attempting to purchase an alternative property. If the subject property is an investment property, specific performance (i.e. requiring the vendor to sell the property) is generally inappropriate and seeking the remedy will not justify a failure to mitigate.

The parties and the deal

Southcott Estates Inc. (the "**Purchaser**") was a single-purpose corporation set up through the Ballantry Group of Companies ("**Ballantry**") to purchase and develop

a property. The Purchaser had no assets except for the deposit money advanced by Ballantry. The Purchaser entered into an agreement with the Toronto Catholic District School Board (the "**Vendor**") to purchase a 4.78 acre surplus property for $3.44 million (the "**Property**"). The deal fell apart when the Vendor failed to satisfy a severance condition and refused to extend the closing date. The Purchaser sued for specific performance and, alternatively, damages, arguing that the Vendor did not use its best efforts to obtain the severance. The Purchaser admitted it had no intention to mitigate its losses by attempting to purchase an alternative property.

Single-purpose corporations have a duty to mitigate losses

The court held that a single-purpose corporation is required to mitigate its losses after a breach by making diligent efforts to find a substitute property. The court dismissed the Purchaser's argument that single-purpose corporations should be relieved from having to mitigate because of their unique nature, limited assets and lack of corporate mandate to purchase alternative properties. In the court's view, not requiring a single-purpose corporation to mitigate its losses would give an unfair advantage to those conducting business through single-purpose corporations and would expose defendants contracting with such corporations to higher damage awards. The court also noted that since the Purchaser claimed to have resources available to complete the transaction, it could have used those resources to mitigate.

The court held that expert evidence established that comparable investment properties were available and, by not pursuing those opportunities, the Purchaser failed to mitigate its losses. The evidence included 81 parcels of vacant undeveloped land and 49 properties subdivided into lots that had been sold between the date of breach and date of trial. Other subsidiaries of Ballantry had also purchased several comparable investment properties in the time since the breach by the Vendor.

Specific performance is generally not appropriate for investment properties and seeking the remedy will not justify a failure to mitigate

It is established law that specific performance is only available where money cannot fully compensate for the loss because the land has some unique, peculiar and special value. In this case, the Purchaser failed to prove that the Property was anything more than an investment opportunity. The court noted that a failure to mitigate may be reasonable if a person has a "fair, real, and substantial justification" or a "substantial and legitimate interest" in seeking specific performance. In the court's view, a person deprived of an investment property does not have such justification or interest in specific performance. Rather, money is appropriate compensation. Since the Purchaser could not justify its failure to mitigate, the court awarded only nominal damages of $1 for the breach by the Vendor.

A note about best efforts

There was no dispute that the Vendor breached the agreement by failing to use its best efforts to obtain the severance. Parties contemplating real estate transactions involving a severance condition should be aware of the kinds of factors courts will look at when considering if a party used its best efforts. In this case, the court found the Vendor failed to contact relevant city staff; delayed processing the severance application; failed to include the proposed plan of use with the severance application; submitted an improper survey; failed to seek appropriate advice; ignored the advice of the Committee of Adjustments; proceeded with the application for severance even after being advised that it was incomplete; and failed to keep the Purchaser informed.

Implications for real estate developers

Real estate developers must be aware of the approach a court is likely to take in the event a single-purpose corporation is involved in a failed purchase and sale transaction. Such corporations are not freed from the obligation to mitigate, despite a unique corporate structure, lack of assets and limited mandate.

If a developer is considering using a single-purpose corporation in a development project, appropriate measures should be taken in light of the *Southcott* decision. For instance, it may be appropriate at the outset of a development project to reconsider the corporate structure adopted. If a single-purpose corporation is used, it may be prudent to have a backup "mitigation plan" in place and provide the single-purpose corporation with the mandate to seek out alternative investment properties if the deal falls apart. Finally, a clearly drafted agreement of purchase and sale may allow a purchaser to obtain the remedy of specific performance in the case of an investment property, notwithstanding the default position at law outlined in Southcott.

If a breach does occur and litigation is contemplated, the decision to seek the remedy of specific performance must be made carefully in light of the facts, including the terms of the agreement of purchase and sale and whether the property is an investment property. Where a development project is likely to be characterized by a court as not unique, absent protections in the agreement of purchase and sale, specific performance is unlikely to be awarded and the purchaser will be expected to mitigate its losses.

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