Commercial Leasing

Doing Business in Canada

AIRD BERLIS

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GENERAL

In Canada, a lease is both a contract and an interest in land. The parties to a commercial lease are free to agree upon such terms as may be negotiated and, in the process, may generally contract out of local provincial legislation governing commercial tenancies.

INITIATING DOCUMENTATION

In Canada, unlike some other jurisdictions, commercial tenants are not often presented with a landlord form of lease at the outset. Instead, the tendency is for commercial landlords to determine if there are the makings of a business deal by producing shorter form leasing documentation at the outset of the relationship. Such documentation can take the form of any one or more of the following: (i) an offer to lease, (ii) a letter of intent or "LOI" (iii) a proposal to lease and (iv) a summary term sheet. A decided benefit to adopting this approach is to expend minimal resources in pursuit of settling core business terms, thereby building valuable momentum for the eventual negotiation of the many "boilerplate" provisions in a lease. If the parties are able to settle the terms of a shorter form leasing document, this will often trigger mobilization of construction forces (i.e., designs, plans, applications for permitting, etc.), thereby enhancing the prospects of emerging from this process with a binding lease. Another justification for this process, in the retail context, is that a landlord may wish to swiftly secure a commitment from a major tenant in order to facilitate marketing efforts in attracting other tenants or perhaps satisfy co-tenancy requirements to which a landlord may be bound. Care needs to be taken to ensure that the lease contains all terms from the preceding documentation in order that a successful merger occurs.

A notice of an agreement to lease is capable of registration in our land titles system in order to preserve priorities, but many landlords restrict such registration unless and until a binding lease is settled for the premises in question. Lenders prefer not to grant non-disturbance agreements on the strength of offers to lease above, but may do so depending on the circumstances. On balance, the sequence of an offer to lease followed by a lease represents the industry norm in Canada, although there can be variations on this theme depending upon, among other things, the popularity of the project in question. Ultimately, most Canadian landlords adhere to the "no lease no keys" policy to satisfy the demands of the lending community.

Ordinarily, initiating documentation is non-binding or, alternatively, conditional on settling a final form of lease. In order to achieve a binding lease (whether by way of an agreement to lease or a lease) all of the essential elements need be addressed, including: (a) identifying the landlord and the tenant, (b) a proper description of the premises, (c) the rental structure, (d) the length of the term, and (e) the commencement date. If any of the aforementioned essential elements are missing, then in all likelihood the resulting agreement to lease or lease will be found to be unenforceable.

Given that a lease is also a conveyance, it is recommended practice that a sub-search of the lands be conducted at this early stage to ensure that there are no pending encumbrances, limitations or restrictions that could impact the settled terms of a lease. A sub-search of title also serves to confirm ownership of the parcel. Moreover, local zoning by-laws need be accessed to ensure that the tenant's planned business can in fact be operated from the premises. Landlords in Canada rarely make any representations or warranties in this regard.

Initiating documentation is not to be taken lightly in Canada as it often sets the stage for the lease negotiations that follow. Any extraordinary rights, including, but not limited to, co-tenancy, restrictive covenant, rights of first refusal, leasehold allowance, rent free period, additional rent cap or non-consent transfers, ought to be worked into the initiating documentation. It is also important to settle landlord and tenant work at this early stage, especially if a tenant wants to avoid accepting the premises in "as is" condition.

LEASE NEGOTIATION

An offer to lease will usually contain a provision requiring the tenant to execute a lease agreement within a certain time period. A failure to do so may result in the offer to lease being declared null and void. Typically, a landlord's form of an offer to lease will provide that the landlord's standard form of lease is to be used though tenants with bargaining power may persuade a landlord to substitute the tenant's form of lease instead.

The ultimate goal is for the initiating document to "merge" upon execution and delivery of the lease, such that the lease will be the only document governing the relationship between the landlord and the tenant. In some cases, but relatively infrequently, the parties will agree that certain terms (for example, construction details) set out in the offer to lease are to "survive" and continue to govern following execution and delivery of the lease.

Landlords' standard lease forms are becoming increasingly complex documents, and foreign tenants should leave ample time to navigate through the negotiation process. While landlords will, in general, entertain reasonable amendments to their standard form of lease, some tenants may not take full comfort from diluted "step down" provisions, thereby necessitating more intense lease discussions. While landlords strive to preserve uniformity among the many leases across their portfolio, tenants are known to challenge standard provisions to reflect their own company policies and to ensure consistency among their own portfolios.

Most tenants are presented with fully "net" leases, such that all operating costs are typically charged back to tenants with very few limits, caps or exceptions. Management or administration fees are payable to landlords as well (usually calculated as a percentage of such operating costs or a percentage of gross revenue from the project). There is no "universal list" of standard inclusions or exclusions of such costs. Typically, all such costs are estimated by landlords with tenants making all payments based on those estimates, and adjustments are made when landlords obtain additional information with respect to the actual costs incurred. Landlords will typically resist any audit rights but will frequently agree to provide reasonable supporting information so that tenants can ascertain the amounts that are payable. Landlords' standard lease forms typically have very strict requirements with respect to use of the premises and conduct of tenants' business operations, as well as extensive restrictions to any potential transfers of leasehold interests.

Almost all of the obligations with respect to the repair, maintenance and insurance relating to the premises are passed on to the tenant, with very few exceptions. Canadian commercial leases now often contain very broad provisions relating to landlord's control or alterations of the building or the project, including rights of relocation. Other provisions that are becoming typical requirements, but may create an administrative hassle for foreign tenants, include, for example, a requirement to pay all rent by pre-authorized debiting or electronic funds transfer. Canadian leases also contain very specific insurance requirements, with insurance providers and policies often subject to landlord's approval. Foreign tenants should involve their local insurance brokers early in the negotiation to review these provisions and ensure compliance. Foreign tenants should be aware that environmental laws, as discussed elsewhere in this publication, are different from those in the United States or other parts of the world and therefore counsel should be engaged to ensure that appropriate protections are negotiated into a lease to limit liability for pre-existing or ongoing environmental contamination.

LEASE TAXES

Consistent with a net lease, tenants are expected to share or reimburse their landlords with respect to taxes (and, for that matter, operating costs) imposed as a result of leasing of their space.

Realty taxes can be a significant liability in commercial real estate leases. For example, in Ontario, realty taxes are assessed using the income stream/revenue model, and separate assessments are no longer available, although one can endeavor to obtain assessors notes from which an assessment can hopefully be "reconstructed." Frequently, tenants from foreign jurisdictions tend to look for billing certainty, but realty taxes are rarely capped or fixed by landlords in Canada, who instead prefer to reserve very wide discretion in how taxes are allocated. In the absence of separate assessment type language in the lease, foreign tenants often strive for a "proportionate share" formula and, in some cases, a Canadian landlord will commit to this allocation methodology.

The rate of sales taxes (GST or HST) charged to tenants varies from province to province. HST is exigible against taxable supplies, which includes all rent paid by a tenant to a landlord under a lease, but in most cases, this is a "flow through" tax that is "neutral" as long as a tenant is registered to collect such sales taxes in its business dealings. GST or HST is also chargeable on leasehold inducements and allowances.

LEASES IN QUEBEC

Quebec is governed by the Civil Code which contains many tenant-friendly provisions. As a result, landlords will typically attempt to obtain waivers in the lease to those Civil Code provisions, and proper legal guidance is highly recommended to maneuver in such regime.

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