so you want to redevelop your property? don't forget about those (pesky) tenants

introduction

Old office buildings, tired shopping centres, run-down industrial parks – all are potential redevelopment opportunities. What was new and exciting forty years ago is now in need of rejuvenation, and if the current owner is not prepared for the effort and risks that such a redevelopment requires, then there is often a developer out there that is. Owners who are also landlords, of course, want to maintain a consistent income from the property while at the same time having the flexibility to terminate leases and/or relocate tenants when the time is right for redevelopment. Tenants, on the other hand, want to be dealt with fairly by a landlord that is contemplating redevelopment. Sometimes arriving at a suitable middle ground can be a struggle.

demolition by landlord

If a landlord has redevelopment in mind, then a right to terminate existing leases so that demolition or substantial renovation can occur may be critical. However, from a tenant’s perspective, such a right, without qualification, can be less than satisfactory. Some of the issues that a tenant must consider include the following:

- whether there should be a restriction as to when the right to terminate can be exercised – e.g. assuming that the tenant has one or more options to extend the term, perhaps only after the initial term has expired;
• what does "substantially renovate" really mean and what parameters should be put around it – e.g. fifty percent or more of the rentable area of the building in which the premises are located, whether or not the premises are directly affected;

• what evidence should the landlord have to provide of the bona fide nature of its intention to demolish or substantially renovate the premises – e.g., professionally prepared plans, building permits, etc.;

• what period of prior notice should be required;

• will there be compensation for the remaining (i.e. unamortized) value of the tenant’s leasehold improvements;

• will the landlord provide any financial assistance to the tenant in locating new premises or in respect of costs the tenant will incur in having to prematurely move to new premises – e.g. brokerage costs, moving costs, the cost of new leasehold improvements, etc.; and

• will the tenant be given any rights to lease premises in the new or redeveloped project.

Landlords must understand that courts will strictly construe a demolition clause when determining whether it allows a landlord to terminate a lease, so the demolition clause must clearly state that the landlord has the right to terminate the lease to demolish the premises.

sale by landlord

A provision in a lease giving a landlord the right to terminate a lease if the landlord intends to sell the building is often included in the demolition provision, or it may be a standalone provision. Such a provision will often require that there be an actual agreement of purchase and sale between the landlord and a potential purchaser before the right to terminate arises. A tenant would want to ensure that any such agreement is "bona fide" and not simply an agreement between related parties entered into for ulterior motives, such as obtaining vacant possession of the premises for other purposes. However, when the trigger for the exercise of the
landlord's right of termination is an actual agreement of purchase and sale having been entered into, the notice period is likely to be relatively short so that termination can be accomplished on or before closing, or even shorter when, as is sometimes the case, it is coupled with compensation for the tenant where the landlord requires the tenant to make a quicker exit.

One might ask why a landlord would want to terminate tenancies in the context of a sale of a building, when the income from the building is usually part of the attraction. Depending on the type of building, the desire to terminate and provide vacant possession of some or all of the building may be desirable. For example, if the subject building is a single tenant industrial building, the market for the building may be expanded if it can be marketed to both investors and owner-occupiers. If the property is a retail plaza or mall that contains a number of underperforming tenants, the landlord may want the ability to terminate those tenancies on the basis that the mall would be more attractive without them, where "remerchandising" may, in fact, be part of the redevelopment plan. With this in mind, when the lease is being negotiated a savvy tenant with sufficient bargaining strength might insist that any such termination be conditional upon the landlord terminating all other tenants (or at least a portion of them based on a specified percentage of other premises or within a defined area of the mall), making it more difficult for a landlord to discriminate among its tenants in the exercise of the termination right.

**redevelopment and relocation**

Sometimes developments are done in phases or are located on lands that are underutilized. In appropriate circumstances, landlords will ultimately want to make full use of the property, whether, in the case of a shopping centre, by expanding the retail component or adding office or residential components, or in the case of an industrial or office complex, by expanding existing buildings or adding new ones. When that occurs, the landlord may have no intention of terminating leases in the existing project, but rather increasing density, making better use of existing facilities or diversifying the type of development on the site. However, for existing tenants this type of "redevelopment" comes with its own set of issues. If these issues can be anticipated when the lease is
being negotiated, a tenant with enough bargaining power may be able to extract from the landlord covenants that require the landlord to:

- maintain free and open access between the premises and other lands and premises that become part of the development;
- maintain a specified parking ratio on the lands;
- ensure existing exclusive rights extend over the expanded area of the development;
- obtain the tenant's consent before building, adding to, or enlarging the existing development; and
- refrain from making any alterations or additions to the development that would detrimentally affect the tenant's business operations, impair access to the premises or obstruct the visibility of the premises (e.g. provisions for "no-build areas" in shopping centre leases).

It may be that in order to redevelop an existing development, the tenant must be temporarily or permanently relocated, whether elsewhere in the development or in a nearby development, if the landlord owns or controls one. In that case, a tenant is going to be expecting the landlord to pay both the cost of moving to and returning from the relocated premises, as well as to provide a substantial contribution to installing new leasehold improvements in both locations. Other issues that typically arise when relocation provisions are being negotiated include the need to adjust rent to account for the larger or smaller size of the relocated premises (and whether there will be any limits on such an adjustment), whether the tenant will have any obligation to re-use leasehold improvements from the existing premises in the relocated premises, whether the tenant requires any "black-out" periods, during which any such relocation cannot occur, eliminating or minimizing down-time, etc. The tenant may also want the right to terminate its lease if the space to which the landlord proposes to have it relocated is not acceptable and, as where a lease is being terminated as a result of demolition or sale, receive payment on account of the unamortized portion of the tenant's improvements in its existing premises.
One area of potential dispute is the comparability of the new location to the old location. From the case law, it is apparent that courts will carefully analyze a relocation clause to assess whether a tenant's new location is sufficiently similar to the old one. Factors that will be considered are location, size and finish of a tenant's new location as compared to the existing premises and, specifically in the retail context, accessibility, customer visibility and customer traffic flow.

The courts also place a significant emphasis on determining the intention of the parties to interpret the meaning of relocation clauses, particularly when there is ambiguity in the drafting, which most often will be construed against the drafter. This can be an especially important and potentially problematic consideration for successor landlords purchasing commercial property in order to redevelop property and relocate tenants.

**Conclusion**

An owner's desire to get the most out of its property and a developer's desire to redevelop older properties are natural instincts in the world of commercial real estate. However, careful planning, starting with careful drafting of the relevant provisions of a lease, is critical in such circumstances. Landlords having the foresight to include well drafted demolition and relocation provisions in the lease when it is originally negotiated can usually avoid ongoing and costly negotiations with its tenants when the time for redevelopment is right.
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a cautionary note

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