

## REDEVELOPMENT

## Tenants halt the wrecking ball's swing

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Scan downtown cores across the country and it's not uncommon to see older shops, offices or other commercial properties being razed or redeveloped. As urbanites know too well, when the wrecking ball swings in cities such as Toronto and Vancouver, a residential building is about to spring up where a commercial one once stood.

When property owners want to redevelop idle land, they simply draw up plans for a new building and then move through the usual steps: permitting, financing and then breaking ground. Trouble is, idle properties are scarce in the centres of Canada's largest cities.

In most cases, they're occupied by existing buildings that are nearly always full of lease-holding tenants. Therein lies the challenge for property owners, says John Crombie, a national retail director with real estate brokerage Cushman & Wakefield Inc.

"The terms and conditions of a lease are binding on the owner of the property," he explains. "If a lease has been executed and a tenancy has, say, 10 more years without any termination issues, then it's a fight. If the tenant doesn't want to move, and refuses to play ball, the landlord can really be in a pickle."

In one particularly nasty – and precedent-setting – landlord-tenant squabble in 2005, the architecture firm IBI Leaseholds Ltd. was asked to vacate its office in a prime downtown Vancouver location by the landlord, Evergreen Building Ltd., which was having difficulty renting out the rest of the tower. IBI refused, despite being offered compensation to relocate.

Evergreen requested permission to rezone the property, level the building and build condos. A B.C. court ruled the tenant's rights as a leaseholder trumped those of the money-losing landlord.

Not long after, the B.C. Court of Appeal sent the case back to trial and the matter nearly reached the Supreme Court a year later. After thousands of dollars in legal fees and tremendous headaches for both parties, Evergreen decided to cut its losses and sell the building, which was later given heritage status, preventing its redevelopment.

Landlords who may one day look to repurpose their properties can take a number of steps to avoid the same roadblocks. "They need to include in their leases a clause allowing them to terminate the lease if they intend to redevelop or demolish the building," says Dennis Daoust of Toronto-based real estate law firm Daoust Vukovich LLP.

Still, ending a lease is easier said than done. "It's very difficult to remove a tenant unless they're in default," Mr. Daoust says. "And even if they are in default and they're willing to cure it, almost inevitably the lease will get reinstated."

To avoid this predicament – and the public relations mess that can come along with it – Mr. Daoust says landlords

need to think ahead when purchasing property or signing leases, particularly with older properties whose values could be augmented by some form of redevelopment.

A developer with a sizable real estate portfolio may also include a relocation clause, allowing it to offer the tenant space on another floor of the same building or in another of its properties. In this case, the relocation costs are typically covered by the landlord.

But not all tenants are willing to move.

“Generally, office tenants are more flexible because the location is a cost to their business. For retailers, it’s a revenue driver,” Mr. Crombie says. Understanding that they also have leverage over a landlord, some tenants – particularly retailers or industrial tenants who make significant improvements to their space, or whose success is largely tied to a specific location – may refuse to budge.

“If you’re a retailer who has five years left and an option to renew, you could argue that your space is generating revenue of \$500 per square foot and a profit margin of 15 per cent, for example, then set your price before agreeing to leave.”

If the tenant agrees to move but protests the suggested relocation site, a lease clause naming a predetermined arbitrator can help resolve the dispute, says Mr. Daoust. But even when such details are tended to, a tenant could still delay proceedings in court.

Another strategy for property buyers is to carefully analyze existing leases before purchasing. If all are set to expire around the same time and don’t have renewal options, it may be a smart buy, says Carol Massoud, a Montreal-based regional director for commercial real estate brokerage Colliers International.

Developers who buy and wait until the leases expire could be making a smart move if the market is down and they are willing to wait for conditions to improve before setting their redevelopment plans in motion.

For landlords who either haven’t thought ahead or who acquire a property and have enough cash, buying out existing leases is always an option. But as Mr. Crombie points out, there is no industry-standard formula for determining just how much compensation a tenant should receive for exiting a lease prematurely.

Which leaves the last, most expensive option for developers: cutting a cheque in the seven-figure range. “Some tenants,” says Mr. Crombie, “view it as their lottery ticket.”