

# 2018 ICSC Canadian Law Conference Roundtable

## Outparcel Leases / Pads

April 30, 2018

We are all quite familiar with the sight of stand-alone quick-service or casual-dining restaurants, banks or specialty retailers sitting in front of enclosed shopping centres or strip centres or sharing huge parking areas on power centres. Tenants choose to operate on these pad sites for a number of reasons: lower rents, visibility, the facilitation of customer access, dedicated parking, the ability to incorporate a drive-thru and/or patio, and the ability to use proprietary branding being foremost among them. These requirements result in certain peculiarities which differentiate pad leases from their mall-bound cousins, although many other leasing considerations remain the same. This paper will briefly address the foregoing requirements with a view to stimulating consideration of these issues and discussion and is by no means intended to be an exhaustive analysis.

### 1. Is it a ground lease or a building lease?

With a ground lease, the tenant leases a parcel of land on which, typically, it intends to construct its premises. Often, the landlord's only obligation in connection with such a lease is the compaction and grading of the site and the bringing of services to the perimeter, which the tenant will then connect to its building. Ground rents tend to be lower than building rents, because the tenant is leasing an unimproved site and, while construction costs may be significant, many sophisticated tenants are able, through long experience with the construction of their premises, pre-fabricated elements or knowledgeable contractors, to manage these costs to their satisfaction. Sometimes, however, ground tenants will require a tenant allowance from the landlord to help pay for the construction of the tenant's building. This allowance is effectively a loan, and will be recovered by the landlord in the rent. The tenant may also elect to lease a completed building, whether then existing or to be constructed by the Landlord. The rents charged for such premises will almost certainly be higher than ground rents. Also, whether the pad premises are to be introduced on a green-field site or on an existing centre, consideration must be given to construction requirements and issues flowing from such requirements, including fencing, portable electricity generation (and the noise of their operation), mud mats for access, staging areas, effects on parking and customer access, and the general unsightliness of the centre during construction. To deal with the latter issue, tenants with more bargaining clout often insist on co-tenancy arrangements such as a particular number of square feet built out and/or in operation before the commencement of their own operations.

### 2. Common Area Costs

The distinction between a ground lease and a building lease inevitably invites consideration of what basket of common area costs the tenant is required to contribute to. Pad tenants will, of course, resist having to contribute to the interior common area costs incurred by the landlord in connection with the adjacent enclosed mall as they will argue that they derive no benefit from the maintenance, up-keep and operation of such mall. Whatever the merits of that argument, the consideration of pad tenants' contribution to exterior common area costs may not be any more straightforward. For instance, if the demised premises of a ground tenant include dedicated parking, such a tenant may resist contributing to the costs of maintenance, up-keep and operation of the larger parking pool serving the centre. Similarly, such tenants may resist contributing to common roof repair and maintenance costs especially if their premises – and roof – are relatively new in comparison to the adjacent enclosed mall or strip centre. Many pad tenants will insist on contributing only to the costs of maintenance, up-keep and repair of entrances, exits and drive-aisles providing access to their premises, perhaps to common signage pylons on which their signs are installed, to common area lighting (whether as a matter of legal requirement or practicality) and perhaps to landscaping. The costs of maintenance, up-keep and repair of underground servicing may be another consideration in cases where such services are brought to the perimeter of a ground lease parcel, with lateral connections to be provided by the ground tenant.

## 3. Visibility and Branding

Often there is language in pad leases which requires that the landlord maintain adequate vista (or visibility) of the premises from streets A and/or B during the term. This may be accomplished by the introduction of a “no-build area”, height restrictions on new buildings or merely a covenant on the part of the landlord to ensure that the tenant’s vista is not materially impaired. Such a requirement would obviously not be possible where the premises are in an interior mall, but consider what that covenant means for the landlord. The landlord’s control of its centre may be compromised, as its ability to construct improvements that could enhance the shopping centre, but affect the tenant’s sight lines, is constrained. Careful consideration would also have to be given to the effect of such covenants on expansion and other rights that may have been granted to other tenants of the centre as well as to reconfigurations of the centre or installations thereon arising through governmental order.

In connection with the enhanced visibility afforded by pad leases, though, comes the tenant’s ability (provided the same is carefully negotiated in the lease) to avail itself of proprietary brand rights, such as colours, building configuration and design and signage that might not be available in an enclosed mall or within a strip as a result of building standard criteria required by the landlord to ensure a relative uniformity of style. Given the importance of these brand rights, of course, the pad tenant will want to ensure that it can “de-brand” its building on expiry of the term or the sooner termination of the lease so that a replacement tenant will not be able to benefit from their continued existence on the premises or so as not to contravene the rights of the ultimate owner of the rights if other than the tenant. If the tenant’s branding is particularly extreme some landlords will even require that the tenant’s building be demolished on expiry of termination of the tenant’s lease and the site of the tenant’s premises cleared of debris and properly graded. Such an obligation would, of course, be quite costly.

## 4. Additional Benefits

Additional benefits of pad leasing include the ability of pad tenants to include a drive-thru area and/or a patio as part of their premises. Such areas may be part of demised ground premises or else part of the common areas, to which exclusive use rights have been granted to the tenant. Base rent is not usually charged on such areas, but the tenant will have broad obligations for the maintenance, up-keep, repair, replacement, insuring and payment of utility charges of such areas, as well as the obligation to ensure that such areas comply with applicable zoning, building, signage, etc. by-laws. In respect of drive-thru areas, in particular, whether such areas are exclusive use or demised, consideration must be had to issues such as the responsibility for snow and ice clearing. Is it easier to have the landlord’s contractor take care of such clearing and have the cost included in common area costs, or would the landlord’s contractor’s schedule be too limiting, and should the tenant undertake such obligation itself? Furthermore, if a patio operates outside the centre’s normal business hours, how will the payment for outside of business hours access and lighting costs be distributed?

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