

January 19, 2007

## Pad Site Deals: Similar, But Different

Pad site deals are often documented by making amendments to a standard in-line (CRU) lease form. This results in a product that only addresses a few of the more obvious differences between an in-line and a pad tenant. A properly drafted pad lease should recognize and address the full spectrum of issues that are unique to pad tenancies. Failure to work through any issue will leave the parties with their interests inadequately protected.

This article focuses on the operating cost, repair and maintenance, and realty tax provisions of a pad lease. However, it doesn't end here. Insurance, damage and destruction, as well as a host of other lease provisions also require special consideration in the context of a pad deal. We can't fit all our advice in one News ReLease, so you'll have to call your favourite leasing professionals for help on these other aspects.

### Operating Costs

Pad tenants usually expect special treatment. They perceive that they benefit from the exterior areas of the centre (being the parking areas, landscaping, and entrances and exits) but not from any interior malls or other buildings on a site. They insist on contributing only towards the "exterior common area costs" of the centre. Care must be taken in defining exterior common area costs; the landlord will want to capture insurance,

salary and management costs even though those costs are not regarded as exterior costs.

Sometimes, the tenant perceives that it receives *no* benefit from the other areas and buildings of a centre and insists on making *no* contribution towards any of the costs associated with the balance of the centre (exterior or otherwise). Where this cost scheme is used, it is common for the tenant to pick up all interior and exterior operating costs (i.e. snow removal, landscaping and parking area repair) associated with its pad premises. Where the landlord performs a service for the benefit of both the pad premises and the balance of the centre (such as snow removal), a portion of that cost should be allocated to the premises.

A simplified approach to the exterior-only versus full CAM issue is to stipulate that the pad tenant will pay a fixed rate per square foot as its contribution to the landlord's operating costs. If so, an annual CPI or other escalation factor is generally included.

Bear in mind that where a pad tenant does not make a full contribution towards operating costs, the pad tenant's area should be excluded from the denominator of the proportionate share fraction used for the other tenants of the centre. Failure to do so will result in the landlord being left in a short-fall position. This is not an item to be addressed in the pad lease. It must be expressed in the other tenants' leases.

## Repairs and Maintenance

The allocation of repair and maintenance responsibilities between the landlord and tenant can be complicated. It is often the case that repair and maintenance obligations are set up as a flow-through from the initial construction obligation. This can be departed from if the landlord contributes the cost of building as an allowance. Then, landlords often absorb structural repairs (which can prove worrisome if the landlord was not responsible for the initial construction of the building) but the treatment of periodic roof resurfacing, HVAC replacement and exterior cladding can be hotly negotiated. Some landlords wish to retain control over certain repairs irrespective of initial construction obligations. Where the landlord is responsible for the repair and maintenance of any items related to the tenant's building, the parties must decide whether the tenant reimburses the landlord for the costs of the repair and maintenance, or pays a share of the costs following inclusion in the general operating costs for the centre.

It is also important to address the allocation of responsibilities for the ancillary exterior areas related to a pad (such as parking areas, patios, garbage enclosures, drive-thrus, sidewalks, curbs and landscaping). Where the tenant has exclusive use of these areas, it is not uncommon for the tenant to be made responsible for their repair, maintenance and replacement (and don't forget to have the tenant indemnify the landlord for any claims

resulting from use of these areas by the tenant and its customers). In some cases, however, it may be more efficient and cost effective to have the landlord repair, maintain and replace these exterior areas. If so, the parties must decide whether the tenant reimburses the landlord for the full costs of the repair and maintenance, or pays a share of the costs following their inclusion in the general operating costs for the centre.

## Taxes

The allocation of realty taxes to a pad site tenant can be done by way of pro-rating (based on area or assessed value). Now that many provinces do not provide separate assessments or realty tax bills for leased space, landlords are faced with an allocation exercise that can lead to shortfall, depending on the way a property's leases are written. Most pad site tenants are determined to pay their "true" share of the realty tax bill (i.e. based on the portion of the bill that is derived from the assessed value of their leased premises). Some are willing to pay a pro-rated share. It is always a good idea to get professional tax advice before landing on one approach or the other.

As you can see, pad site leases are not simply CRU leases minus the shared HVAC provisions. While we've only shown you the tip of the iceberg, we hope you're left with the impression that pad deals require careful thought and drafting. Making patchwork and cursory amendments to your standard CRU lease will sink your next pad deal!



Our secret for closing files lies as much in what is taken out as in what is put in. By eliminating exorbitant expenses and excess time, by shortening the process through practical application of our knowledge, and by efficiently working to implement the best course of action, we keep our clients' needs foremost in our minds. There is beauty in simplicity. We avoid clutter and invest in results.

Often a deal will change complexion in mid-stage. At this critical juncture, you will find us responsive, flexible and able to adjust to the changing situation very quickly and creatively. We turn a problem into an opportunity. That is because we are business minded lawyers who move deals forward. The energy our lawyers invest in the deal is palpable; it makes our clients' experience of the law invigorating.

MARY ANN BADON  
416-598-7056  
mbadon@dv-law.com

FRANCINE BAKER-SIGAL  
416-597-8755  
francine@dv-law.com

JEANNE BANKA  
416-597-0830  
jbanka@dv-law.com

JOANNA BOARD  
416-597-9225  
jboard@dv-law.com

DENNIS DAOUST  
416-597-9339  
ddaoust@dv-law.com

BITALI FU  
416-598-7053  
bitalif@dv-law.com

JOSEPH GRIGNANO  
416-598-7049  
jgrignan@dv-law.com

S. RONALD HABER  
416-597-6824  
rhaber@dv-law.com

WOLFGANG KAUFMANN  
416-597-3952  
wolfgang@dv-law.com

LYNN LARMAN  
416-598-7058  
llarman@dv-law.com

MIMI LIN  
416-597-8493  
mimil@dv-law.com

DAWN MICHAELOFF  
416-597-8578  
dmichaeloff@dv-law.com

JAMIE PAQUIN  
416-598-7059  
jpaquin@dv-law.com

FRANCES PENG  
416-598-7038  
fpeng@dv-law.com

ALICE PERALTA  
416-597-1536  
aperalta@dv-law.com

NATALIE VUKOVICH  
416-597-8911  
nvukovich@dv-law.com

DEBORAH A. WATKINS  
416-598-7042  
dwatkins@dv-law.com