

# 2020 Real Estate Roundtable Fact Pattern

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Thursday, October 29, 2020



# Background

Cowboy Jim has decided that 2020 is the perfect time to deploy additional capital that was earned by refinancing his family's Blueberry Farm in the Agricultural Land Reserve. He has always had his eye on a mixed use development on Main Street named Shady Mews. Shady Mews has four floors of office space, 32 residential rental units and 7 ground level retail units. The ground level retail tenants are: Nacho Daddy Mexican Restaurant, Wok this Way Japanese, Everyone's Welcome Credit Union, Get the Funk Out Laundromat, Hyper Slow Yoga Studio and Julius Scissor Hairdressing. The last unit is vacant.

Cowboy Jim has submitted an offer to purchase Shady Mews and is currently completing his due diligence on the property.

## Overcoming Obstacles: Acquisition and Financing in a Pandemic

Cowboy Jim has already obtained an initial commitment for acquisition financing from his favourite lender who has put some specific financial covenants in the commitment (including a net operating income covenant) and made it clear to Jim that the bank will not be flexible on these numbers. During his review of the materials in the data room, Cowboy Jim has discovered that the seller has granted the tenants a number of rent concessions.

1. Unfortunately Wok This Way did not qualify for any government assistance, however the seller had agreed to grant them three free months of rent in April, May and June 2020 which were to be repaid by the end of 2021.
2. Nacho Daddy was in default of their obligation to pay rent in April and May 2020. Nacho Daddy was able to catch up on rent after opening an expanded outdoor patio under the City of Vancouver's Temporary Expedited Patio Program. However, Cowboy Jim is concerned that the coming rainy season may impact Nacho Daddy's ability to pay rent in the future.
3. A number of the office tenants have vacated their premises and while all office tenants are current with rent payments, there are a sizable number of emails and letters requesting that the seller consider reducing their rent or consenting to sublease or transfers of their space.

Given the bank's earlier statement that it will not be flexible on the financial covenants, Jim lets his contact at the bank know about the tenancy issues. The bank comes back with an amended deal that includes revised financial covenants, but also a requirement for additional guarantees from two of Jim's deal partners. Jim's partners are reluctant to agree.

### Issue #1 Maxwell Carroll and Scott Anderson

What should Cowboy Jim consider addressing in the contract before going firm? How might the issues with rental income impact Cowboy Jim's ability to close with his acquisition financing? What arrangements might Jim propose with his partners to induce them to agree to the lender's guarantee request?

## Winter is coming... but first, the *Land Owner Transparency Act!*

Cowboy Jim has heard grumblings from his buddies at the local saloon about some fancy new government legislation called the *Land Owner Transparency Act* ("LOTA"). He has heard that starting November 30, 2020, he'll have all kinds of new reporting obligations whenever he does a real estate transaction. He has also heard that he's going to have to start publicly disclosing information about the crew of bandits that invest in his developments – even for properties he already owns. His developer pal Dodger Dan even thinks this information is going to be used to impose taxes on beneficial transfers.

Cowboy Jim's head starts spinning every time his buddies try to explain all the changes that are coming. Realizing that he needs to figure out these new LOTA requirements before acquiring Shady Mews, Cowboy Jim thinks he'll need to speak with his lawyer about the process. He is planning to register title to Shady Mews in the name of a newly formed corporation.

This also gets him thinking about some other projects he has that are already underway, including a development in Squamish he has registered in the name of a nominee company. His cash flow has been tight due to Covid-19 and he is debating selling the whole Squamish project or partnering with another developer to help complete it.

### Issue #2 Ed Wilson and Brendan Craig

Jim wants to know what new steps he will need to take under LOTA when acquiring Shady Mews. He also wants to know if there is anything he needs to do now for the Squamish project to meet his obligations under LOTA. What about when he sells the Squamish project or brings on a new partner?

Being stuck at home with his constantly misbehavin' children through Covid-19 isolation has also got Cowboy Jim thinking about moving to a bigger house in the countryside. Is there anything new that he will have to do when he buys a new house? What if he decides to stay put in his current home for a few years?

## Finding Force Majeure and Frustration

After Cowboy Jim removes subjects on the acquisition of Shady Mews, the Vendor passes along a licensing inquiry from a company called Santa's Square Ltd. that wishes to organize a Christmas market on a portion of the parking lot in November and December. They begin negotiating the terms of a licence agreement. Santa's Square has offered a \$50,000 deposit but wants to include a clause that requires a return of the deposit in the event of force majeure.

After closing, shortly before the Christmas market is due to open, the local newspaper reveals a significant Covid-19 outbreak at a high school one block away from the Shady Mews that has spread to teachers and parents. In a news briefing, Dr. Bonnie Henry cautions the public about holiday shopping and gatherings of family and friends in advance of the season, and that the province is reviewing appropriate policies. Local reporters speculate on the likelihood of shutting down Christmas activities like parades, markets, and light displays. The next day, Santa's Square claims an event of force majeure has occurred and tells Jim that they want to cancel the market and get a refund of their deposit. Santa's Square also tells Cowboy Jim that, even if the latest developments are not force majeure, the contract is frustrated and is no longer binding. Cowboy Jim has spent significant resources supervising the organization of the market, dealing with Covid-19 protocols and liaising with tenants. He was also counting on the Christmas market for income and to drive traffic to the development.

### Issue #3 Jack Yong and Julia Winters

Did an event of force majeure occur? Is the contract frustrated?

## Terminating a Commercial Tenancy

In the months following closing Cowboy Jim noticed that the pandemic has had a significant impact on the business of a number of the tenants at Shady Mews. Get the Funk Out Laundromat failed to make the rent payment for September, but paid October rent on time. Julius Scissor Hairdressing has stopped operating but has been making partial rent payments. Hyper Slow Yoga has reopened and is conducting business out of the premises but has not paid rent since July.

Cowboy Jim wants to terminate these leases. He also has financial obligations to meet and is struggling to do so without timely rent payments. Cowboy Jim thinks he could recover some of his losses if he can sell some of the expensive equipment that the tenant has installed in the hair salon. He also thinks he could find new tenants for two of the units quite quickly. Jim wants to hold off on re-letting the Yoga studio's space until he thinks the market for a unit that size has gotten better.

### Issue #4 Mike Morgan and Camille Chisholm

Each of the tenants have slightly different leases, which were negotiated with the previous property owner. Cowboy Jim has not reviewed the lease terms in much detail, and wants to know what he should consider when taking steps to terminate these leases.

## Subletting Office Space

Travel Corp., a travel agency that leases its head office space at Shady Mews, has fallen upon hard times recently. The Covid-19 pandemic has slowed Travel Corp's business dramatically and the associated uptick in working from home has significantly lessened its office space needs. In a bid to cut costs, Travel Corp. has been exploring its subleasing options and has discovered that, Mask Corp., the corporate offices of a face mask manufacturer and one of Travel Corp.'s fellow office tenants at Shady Mews, has seen its business significantly increase during the pandemic. Travel Corp. and Mask Corp. ultimately come to an agreement whereby Mask Corp. will sublease a third of Travel Corp.'s premises for the purposes of storing some excess chemicals required in the manufacture of Mask Corp.'s face masks, as well as for various other administrative purposes. To Travel Corp.'s delight, Mask Corp. is so desperate for space that they offer to pay a premium of \$5 per square foot above and beyond the base rent stipulated in Travel Corp.'s lease. Mask Corp. also anticipates having to complete substantial renovations to the sublet premises in order to accommodate its intended use. The sublease agreement is conditional upon obtaining the landlord's consent, but the parties are confident, as the lease provides this consent is not to be unreasonably withheld. The parties approach Cowboy Jim to dispense with what they view as the formality of landlord consent.

### Issues #5 Devin Itterman and Devlin Steers

Given the head lease requires that consent is "not to be unreasonably withheld", what are some of the key factors Cowboy Jim should consider in determining whether to consent to the sublease? How does the proposed change of use by Mask Corp. factor in to the equation? Is Cowboy Jim able to share in any of the windfall attributable to the higher rent being paid by Mask Corp. under the sublease? How will documents ancillary to the head lease (such as amending agreements) impact the proposed sublease? What rules should govern Mask Corp.'s stated intention to renovate the property? What relief could a "recapture right" provision in the head lease provide?

## Leasing Challenges in a Covid World

After closing Cowboy Jim signs a 10 year lease at above market rates for the vacant retail unit with Beyond Leather, who are an up and coming high end vegan fashion retailer out of Milan and have decided to open their Canadian flagship store at Shady Mews.

Jim is thrilled that there will be a high profile tenant operating in the development. However, a couple of months into the term Beyond approach Cowboy Jim and advise him that sales have been slow and they are struggling to pay the rent. Beyond are hopeful Cowboy Jim will grant them some sort of rent concession in order to get them through to the Christmas period. Jim doesn't want to lose Beyond as a tenant as he believes their presence will raise the profile of the development. He is considering calling up his tenant contact in Milan and telling her not to worry about the rent until Covid-19 blows over, and that he'll work out a reasonable repayment schedule later.

### Issues #6 Lisa Frey and Andrew Mildenhall

How should Jim approach any potential rent concessions with Beyond? Should he be entering into a written agreement with them? If so, what should be in the agreement and what does he need to be cautious about?



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# About Our Real Estate Group

Lawson Lundell's Real Estate Group acts for developers, institutional and private investors, pension funds, pipeline, mining, energy and utility companies, contractors, and government agencies who undertake and manage a broad range of real estate projects and portfolios, including commercial, industrial, institutional, residential and mixed use.

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