UNCOMMON COMMON AREAS

Multi-tenanted commercial properties are principally comprised of two types of areas: leasable premises and commons areas. With respect to the latter, a leasing professional's mind will likely turn to an image of a corridor, an elevator lobby or a washroom – these are truly common, common areas.

We understand the term "common area" to be a space shared by and available to many different users - primarily a property's occupants. However, today's commercial properties and their owners compete in a fierce market each vying for the best tenants at the highest rental rates. As such, today's commercial landlords have developed and incorporated commons areas which go far beyond simple stairways, elevators and washrooms. In today's commercial leasing marketplace tenants are wooed by parking facilities, fitness areas, parks, conference facilities, shopping concourses and food courts, all of which are far from "common". These a-typical areas require landlords, property managers and their counsel, to re-consider the "traditional" operating model and cost recovery mechanisms and to re-visit their standard form lease to ensure it properly addresses these unique spaces.

This paper first addresses traditional common areas and how the operation of these areas is typically dealt with in the leases. We then shift our focus to introduce a-typical common areas and the challenges they pose to both landlords and their tenants.

Traditional Common Areas

Lobbies, corridors, stairways, elevators, washrooms play an important role in almost all commercial properties - they allow tenants to access their respective premises and to share common washrooms. Commercial leases address this function by including a short provision granting the tenant a non-exclusive license in common with others entitled thereto over certain areas of the building which are <u>not intended to be leased</u> (note the test is that the area is not intended to be leased, as opposed to the much more limited wording <u>intended to be for the benefit of all of the tenants</u>), as determined by the landlord from time to time. Sample provision:

> "The Tenant is granted the right of non-exclusive use, in common with others entitled thereto, of the Common Areas for the purposes from time to time permitted, approved or designated by the Landlord, subject to the management and control of the Common Areas by the Landlord."

Also note that because the tenants are being granted a licence to use the common areas, these areas should not include areas, which while not intended to be leased, are also not intended to be used by the tenants, as for example, service areas such as boiler rooms, the roof, exterior wall assemblies and the like. These areas are often described in a defined term such as "Service Areas" and specifically excluded from the common area definition.

The scope of what is included in the common areas will not only affect what tenants and other users are permitted to have access to, but will also generally inform the extent of what is excluded from the tenants' maintenance or repair obligations. Normally, the lease will not require the landlord to operate, maintain and repair the common areas, but will permit the landlord to recover its costs should it elect to do so. In negotiating their net leases, most tenants will not have the bargaining power to amend the landlord's lease form to require the landlord to contractually obligate itself to operate, maintain and repair the common areas, but will instead rely on the practical reality that because all of the landlord's costs incurred in this regard are recoverable from the tenants plus the landlord's administration fee, there is no disincentive, and in fact a real financial upside, to the landlord undertaking these obligations.

THE NEED TO BE FLEXIBLE

AND PERMISSIVE

When defining what constitutes a common area in the lease, it will be important to the landlord to ensure that this definition avoids being either narrow or static. Referring to the above sample provision, we note the phrase "*from time to time permitted, approved or designated by the Landlord*". Things change, commercial properties evolve over time and so must the common areas. Flexible and permissive language is important. Above all

else, the landlord requires the discretion to close, open, relocate and change the common areas in response to operational requirements and an ever changing consumer landscape. Take for example, a shopping centre parking lot. The landlord will require the right to close parts of the parking area from time to time to accommodate the anchor tenant's right to use a part of the lot for a seasonal selling area, as for example, a garden centre. An office landlord may require the right to dedicate one of the building's elevators to a particular tenant. In order to accommodate these requirements, the landlord's template lease must allow the landlord the discretion to change and re-designate what constitutes the common areas.

TYPICAL COMMON AREA COSTS

ARE INCLUDED

IN THE OPERATING COSTS AND

RECOVERED FROM ALL OF THE

TENANTS

Money is always top of mind. Having defined what constitutes the common areas, the next most important lease consideration will be to determine who is going to pay to operate and maintain these common areas and how these costs will be recovered. "Not me!" says every landlord in Canada on the rational that these areas are operated by the landlord for the general benefit of all of the tenants and their customers, and as such, these costs are properly reimbursed by the tenants.

In the simplest scenario, the landlord will include all of its costs in a single pool of operating costs and will recover a share of these costs from each of the tenants. Typically, each tenant's share of this single pool of operating costs will be their proportionate share determined by a fraction the numerator of which is the rentable area of the tenant's premises and the denominator of which is the total rentable area of the building. In the case of typical common areas, most would agree that this is the most equitable way to allocate these costs.

But what of common areas that are not shared by all of the tenants, as for example, a parking

garage or area with controlled access? Is it fair to share the costs to operate the parking garage amongst all of the tenants even if they don't have a right to park there? With this we now sail into the challenging waters of a-typical common areas.

A-Typical Common Areas

What makes a common area a-typical? The characteristics of a particular space may necessitate the area to be treated in a manner that is different from the usual common areas – as for example, a shared conference facility. On the other hand, it may be that the area requires special treatment simply because not all of the tenants will be entitled to use the common area, as for example a restricted parking area, or because the common area is open to the public at large not just the tenants and their customers, as for example the PATH in Toronto or the RÉSO in Montréal or the plus 15 system of skywalks in Calgary.

WHAT MAKES A COMMON AREA A-TYPICAL?

As soon as we move away from the typical common areas, we raise concerns regarding who will operate the common area, who will have the right to use it and who will pay for it.

We spoke above about the typical and most simplistic manner of allocating operating costs as involving including all of the costs in a single pool of costs and requiring each of the tenants to pay its proportionate share of these costs based on the ratio any particular tenant's leased area bears to the whole of the building. There are, however, instances where this simple means of allocating costs will not be fair.

FOOD COURTS AND WEIGHTED AREAS

Perhaps the most typical example of where a simple pooling of the operating costs is not an equitable cost recovery method, revolves around food courts. Let's consider a shopping centre with a food court. Ignoring anchor tenants, at a simple level, there are two categories of tenants in shopping

centres: CRUs (or commercial retail units) and food court tenants. Food court tenants typically occupy very small leased space, being comprised of their order counter and prep area, but share a large common area with the other food court tenants where their customers sit down to consume their food purchases. Compare this to the CRUs whose entire business is carried on within their premises. Were the landlord to simply allocate operating costs on the basis of proportionate shares based on the actual area of each tenant's leased premises, the CRUs would be paying a significantly greater portion of the operating costs than the food court tenants, simply based on the relative size difference between the two types of tenancy. Landlords generally deal with this initial discrepancy by "weighting" the area of the food court premises; that is they increase the area of the food court tenants by a certain factor. This weighting may be limited to the determination of the food court tenants' proportionate share of the operating costs and realty taxes or may extend to the calculation of the basic rents.

In addition to the area discrepancy, the food court common area is primarily for the benefit of the food court tenants, not the CRUs.

USE SEPARATE OPERATING COST POOLS TO MORE FAIRLY ALLOCATE TENANT SPECIFIC COSTS

Despite the weighting of the area of the food court tenants, is it fair to expect all of the shopping centre tenants to contribute to the cost of operating the food court common area? In most cases, the landlord will create a separate pool of operating expenses in relation to the operation of the food court and collect these costs from the food court tenants alone. This food court operating cost pool will include things like the cost to clean the food court, collect and remove the garbage and food trays etc. In many leases, these food court costs are found in a schedule applicable only to food court tenants. The schedule is relatively straightforward, but will include an additional definition of costs for which only the food court tenants are responsible.

When acting for tenants in properties with food courts, or other similar types of common areas with clearly identifiable extra costs that can and should be collected from a select pool of

tenants, leasing counsel need to pay particular attention to how operating costs are being determined to ensure that these special costs are excluded from the operating costs in order to avoid any possibility of double dipping. Landlord lease forms are generally permissive in this regard giving the landlord the right to charge certain operating costs to certain tenants based on use and other factors, but not the obligation. If the tenant has the leverage to do so, it would be advisable to change the "may" to "shall" thus requiring the landlord to create a special pool of costs and charge it to the benefitting tenants rather than sharing these costs amongst all of the tenants.

We discussed above how a non-exclusive license to use "traditional" common areas is granted to all tenants, but what about our underground parking garage example where not all tenants are entitled to use this facility?

USE SEPARATE OPERATING COST POOLS TO ADDRESS RESTRICTED USE COMMON AREAS

Some common areas are not common at all. While they are not "leased area", their use is restricted to a select group of tenants or other users, as for example parking spaces in a controlled access parking facility, or the right to use a conference facility or secure bike storage. The right to use these restricted access type common areas may be dealt with by side agreement, as for example a parking licence agreement or telecom rooftop licence agreement.

Despite this restricted access, these areas are often treated as common areas in the leases so that the landlord's costs in operating these facilities can be recovered through operating costs. This is particularly applicable where the landlord believes the operation of the area should or needs to be subsidized, for example, a cafeteria in an outlying office tower. The landlord's rational is that these areas are amenities of the property accommodating the tenants' requirements or making the property more appealing to the tenant's customers. Tenants with sufficient bargaining power will want to ensure that (i) they are getting the benefit of their full proportionate share of the facility, eg. parking spaces within the parking garage, and (ii) the costs that may be included in the operating costs are net of the revenues received by the

landlord on account of the operation of the parking garage. If the tenant is not interested in getting its full share of the parking spaces, it will want to try to exclude these costs from the operating costs and require the landlord to create a separate pool of operating costs in relation to the operation of the parking garage to be collected from the tenant users of this facility and not from the tenants at large. Unfortunately for small tenants, neither of these options is likely to be available to them.

Let's examine for a moment, the example of a common-use conference facility which is made available for use by the tenants from time to time on some sort of reservation system and for which the tenant will be required to pay a user fee.

CONSIDER HOW SPECIAL USE AREAS WILL BE "SHARED" AND ADDRESS THIS IN THE LEASE

If the availability of this common-use facility is important to the tenant, it is imperative that the tenant address this in their lease. Usage rights premised on a "first come, first served" basis may not address the tenant's requirements if it has leased its space on the expectation that it will have access to the conference facility for all of its scheduled board meetings. Likewise, the landlord will want to ensure that no particular tenant can pre-book the facility for inordinate periods of time thus converting what is supposed to be a shared resource for the tenant's personal use. A tenant that is counting on the conference facility being operated throughout the term of its lease will also want to be sure that under no circumstances will the landlord be permitted to elect to discontinue or substantially decrease the operation or availability of this particular common area.

Where the landlord is extracting a fee for use payment, it will want to ensure that such payments are treated as additional rent under the lease, so that any failure to pay this amount may be collected in the same manner as a failure to pay rent.

Speaking of default, the landlord will want to ensure that any tenant's rights to use these restricted use type common areas are forfeited if the tenant is in default. Clearly, a tenant who

is leasing space on the assumption that it will have these rights will likewise want to ensure that it cannot be deprived of these rights unless it is given ample notice of and time to cure the default and will want the rights to be reinstated once the default is cured.

We have all heard of the exciting attractions landlords have implemented at their properties, from roller coasters to daycares. Operating these types of a-typical common areas may require certain expertise the landlord may not possess or necessitate a level of involvement and oversight that the landlord is not prepared to undertake, in which case, the landlord may consider outsourcing the operation these a-typical common facilities to a third-party operator. If the landlord licences the area to an independent operator, the landlord may nonetheless recover the share of operating costs that would have been payable by the operator of the facility had it been "leased" to the operator, in that the area of this "common area" may be included in the gross-up of the rentable area calculations of the tenants' leased premises and thus the landlord is able to recoup 100% of its operating costs despite the fact that it is not collecting any "operating costs" from the operator of the facility. If including the area of the facility in the rentable area gross-up will increase the gross-up to above market acceptable limits, the landlord could instead define the denominator of the pro share fraction (notionally, the rentable area of the property) to limit it to the aggregate rentable area of all leased premises thus excluding the area of the facility from the denominator of the fraction and again providing for 100% cost recovery despite not collecting operating costs from the operator of the facility. All of this may be acceptable to the tenant depending upon whether it views the common facility in question as an important building amenity or not.

OPERATING COST RECOVERY FROM INDEPENDENTLY OPERATED COMMON FACILITIES

The foregoing presupposes the landlord has elected to treat an a-typical use as a common area. There are, however, very cogent reasons why a landlord would instead to "lease" the facility rather than licence it to a third party operator – one of which is undoubtedly a concern regarding liability. The amusement features at the West Edmonton Mall, for example, are

tenanted facilities paying rent like any other tenant in the mall.

The landlord will also need to consider whether it requires specific tenant acknowledgments or waivers to address the less than ideal ramifications of the presence of certain common areas. For example, tenants with premises surrounding a noisy common area feature may complain that the enjoyment of their premises is affected by the landlord's operation of the common area. In Toronto, as part of its entrance connection agreements, the Toronto Transit Commission requires the developer/landlord to include in all leases for the development, a TTC Interferences Warning pursuant to which the tenant acknowledges that the proximity of the property to the TTC transit operations may result in noise, vibration, electromagnetic interference, stray current, smoke and particulate matter transmissions and agrees to release and indemnify the TTC in this regard.

In conclusion, the designation, operation, and cost recovery of a-typical areas can and must be addressed in the lease, but to do so appropriately requires thought, foresight and not an insubstantial dose of creativity. By paying particular attention to how "*common areas*", "*proportionate share*" and "*operating costs*" are defined, landlords can ensure that all common areas are fully funded by the tenants. However, landlords are well advised to do so equitably by varying the denominator of the pro share fraction and by pooling certain costs and limiting their recovery to the tenants benefitting from the common area in question. Likewise, tenants will want to be sure that they are getting the full benefit of those common areas that matter to them and avoiding paying for those that they do not.

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