THE REAL WORLD OF DEFAULTS IN COMMERCIAL LEASES

"…the landlord can sue for rent owing until the end of the lease. Right after it's done getting blood from a stone."

BY MOIRA WALLACE B.A, M.A, LL.B

For the most part, commercial leases are drafted in favour of landlords giving them several options if a tenant defaults. Landlords typically can accelerate the rent, terminate the lease, re-enter and take back the premises, distrain against the tenant's property, claim rent for the remaining term and/or take other steps to correct the default and recover the landlord's costs in doing so. Sounds menacing; meet the real world.

A tenant is in arrears on rent, repeatedly short-paid its rent and not paid the utilities. When asked for payment, the tenant claims a holdback for problems in the premises. The landlord can tell the tenant is in financial difficulty; the problem has been ongoing. The landlord has been lenient, wanting to work with the tenant, keep the premises occupied and save enforcement costs. Last month's rent cheque bounced and the straw breaks the camel's back.

The landlord only has two realistic options; distress or terminate. Not both. If the landlord chooses to distrain, it must physically remove the tenant's property from the premises. The property can be sold and applied to arrears after the tenant has been notified of and given five days to pay the amount owed. Two independent appraisals of the property must also be done to prevent a fire sale. If the tenant pays, its property is returned and it's back in business. If not, the property is sold and assuming money is leftover, it's paid to the tenant. The lease continues, but the tenant is likely out of business because it has no property or goods to sell. The landlord still has no rental income.

If the landlord terminates the lease, it has to evict the tenant from the premises, which means changing the locks. A lockout can only happen when the tenant has not paid rent 15 days after it was due. Depending on the lease, rent may include additional rent items, like utilities. If rent is due on the first, count 15 whole days starting on the second. At the end of Day 16, the landlord can change the locks and post a notice of eviction and lease termination. A warning to the tenant is not needed. The tenant has a right to get its property back, but not by cutting the locks. Doing so may earn the tenant a trip to jail for break and enter. If the tenant doesn't come back for its property, the landlord can sell it.

Cha-ching. To end a bad lease relationship, the landlord must spend money to repossess the tenant's property or lock it out. Both are best done through a bailiff who has experience and is impartial. Otherwise, the tenant may claim the landlord stole property or money during the lockout or repossession. More costs for the menacing landlord.

Imagine the tenant foresees or gets wind of the landlord's plans; it removes all of its property or camps out at the premises. The landlord must then get a court order to gain access to where the property has been moved or to forcibly evict the tenant with the help of police. Costs continue to rise for the landlord who hasn't recouped its original rental income loss. On the bright side, the landlord can sue for rent owing until the end of the lease. Right after they're done getting blood from a stone. BL

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Expect and embrace volatility in 2012

"Given events around the world, 2012 is shaping up to be a great year to embrace volatility."

BY JONATHAN M. WELLUM

In a world with more than $210-trillion (U.S.) in outstanding debt instruments, well over $150-trillion (U.S.) in unfunded liabilities and promises (government social welfare schemes) and $708-trillion (U.S.) in unregulated derivatives supported by $150-trillion (U.S.) in assets, it's easy to understand that the global economy is flat broke! The modern economic construct of how we conduct our fiscal policy (government spending and taxation), monetary policy (level of interest rates and money supply), and fractional banking system and risk management policies is built on flawed assumptions.

Canadians seem oblivious to the precarious state of the global economy, opting to believe that we are insulated from these severe problems. The reality is we are faced with the same challenges. Here are four significant issues facing Canada:

1. Massive exposure to the financial services sector. This includes both banks and insurance companies. The total bank assets of the six largest Canadian banks are approximately 200% of Canada's GDP. This does not include our exposure to the global life insurance companies based in Canada. This includes such firms as Manulife Financial, Great-West LifeCo and Sun Life Financial. Given we live in the midst of the biggest bond/debt bubble in the history of the world, a large exposure to leveraged financials is risky! The need to bail out any of these "too big to fail" companies would change Canada's financial position in an instant. It is a fallacy to believe that our financial institutions are immune to the global debt problems.

2. Large and unsustainable government debt. In Canada, it is crucial to include both federal and provincial debt. The truth is we are facing a bleak future in Ontario unless we immediately slash the size of the provincial bureaucracy and balance our budget. Ontario residents bear a provincial debt load equal to 40% of Ontario's GDP. When combined with the federal debt, our total debt to GDP is approximately 80% and growing quickly. This level of debt is unsustainable and dangerous.

3. The personal debt level of Canadians continues to grow at a record pace. Household credit market debt—which includes mortgages, consumer credit and loans to personal income just climbed past 149%. This is the highest on record and even higher than the U.S.

4. The Canadian housing market is now frothier than the U.S. market at its peak. Despite the wages of Canadians' falling, adjusted for inflation, we continue to bid up the prices of our homes and take on larger and larger mortgages.

Given the global debt crisis, coupled with our own challenges, it is reasonable to expect more volatility in the year ahead, both at home and abroad. The critical question: are you prepared to take full advantage of the volatility? At ROCKLINC we view 2012 opportunistically! Seldom is there a better time to accumulate positions in great businesses than in the midst of turmoil. The best thing in the world is to buy from a forced seller. On the flip side, it is the worst thing to be a forced seller. This means it's essential that you arrange your affairs in such a way that you will never be in a position of selling at the worst of times. This only requires two items: a strong collateralized balance sheet and a robust mindset that is prepared to strike at the right time. Given events around the world, 2012 is shaping up to be a great year to embrace volatility. BL

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