The Development Process On First Nations Lands

Key points

- The legal vehicle for land development on a reserve is a head lease between Indian and Northern Affairs Canada and the developer in the case of First Nations without Land Codes and a head lease between a Locatee or the First Nation and the developer in the case of First Nation with Land Codes. Purchasers' subleasehold titles flow from the head lease.
- Head leases can take a variety of forms; each different form of head lease has pros and cons that should be considered.
- Negotiating the head lease is critical to the success of the development. It is important for the developer to address the following issues:
    - length of term (the longer the better);
    - payment of rent (having it fully prepaid or prepaid for portions of land as they are subleased is important for marketability);
    - environmental assessments;
    - uses; and
    - mortgageability of the subleases (the subleases must permit sublessees to mortgage the sublease, and various provisions should be included to make the sublease attractive to lenders).
- First Nation councils have powers similar to municipalities regarding zoning and bylaw creation. Often a First Nation's development approval process and zoning bylaws are not in place at the time the developer wants to start a project.
- If the First Nation does not yet have a development approval process and zoning bylaws in place, it is crucial that the developer and the First Nation enter a development agreement dealing with: zoning, jurisdictional issues, the development approval process, services and facilities, parks requirements, access requirements, heritage matters, cost contributions, latecomer charges, property taxes, rights of way, assignability, discrimination, and dispute resolution.
- Some First Nations are enacting Land Codes under the First Nations Land Management Act, S.C. 1999, c. 24. for example, the Westbank First Nation on July 1, 2003 instituted a Land Code governing transactions dealing with Westbank Reserve Lands and procedures for registering instruments affecting the reserve lands. Such a code replaces the Indian Act provisions on registration of interests in First Nation lands, and removes Indian and Northern Affairs Canada from the lands management process to a greater extent.

Head lease structures for on-reserve land development

On-reserve development may be undertaken by the First Nation itself, by a non-aboriginal party, or by a joint venture or partnership consisting of both the First Nation and a non-aboriginal party. Whether one is proceeding as a joint venture with a First Nation or developing a project on-reserve without the participation of a First Nation, the legal vehicle that will be used is a head lease between the Minister of Indian and Northern Affairs Canada ("INAC"), and the developer entity in the case of First Nations without Land Codes and between the Locatee or First Nation and the developer entity in the case of a First Nation with a Land Code. Because the head lease creates the leasehold title from which all purchasers' subleasehold titles will flow, the terms of the head lease are critical to the success of the venture. Assuming we are discussing a residential project (which could include recreational aspects), the head lease could take one of several forms:

(a) a long-term head lease with five-year rent review periods;
(b) a long-term fully prepaid head lease;
(c) an unprepaid head lease with a trust fund set up to secure payment of rent under the head lease;
(d) a series of head leases, one for each phase of development, which are fully prepaid as each head lease commences and as each phase commences construction;
(e) a long term head lease of a single parcel, which permits development in blocks;
(f) a long term head lease which is prepaid as to each parcel subleased as the parcels are subleased and in any event, fully prepaid within a limited period of time.

We will look at some of the benefits and drawbacks from the developer's, purchaser's and lender's point of view in each of the above structures.

A. Long-term head lease with five-year rent review periods

This particular structure has fallen out of favour for residential developments because of the uncertainty it creates for the sublessees with respect to the level of future rents. Especially since the Musqueam matter has gained media attention and people have seen the actual effects of rent reviews that are tied to fair market value, it would be very difficult to do a residential development where one expects to sell subleases using a rent review model. These types of leases are still sometimes used in developments that have an ongoing cash flow, such as mobile home parks and golf courses.

B. Long-term fully prepaid head lease

This vehicle provides the ultimate in security for purchasers and lenders, but is less attractive to the developer because of the very large outlay of funds required to fully prepay a long term head lease. For any lease of 49 years or more, the developer will be paying essentially the same value as if it were acquiring a fee simple interest in the land.

C. Unprepaid Head Lease with trust fund

Another attempt to provide security to sublessees is the situation in which the sublease provides that a portion of the prepaid sublease price be paid into trust until the head lease has been fully prepaid. Because the trust fund may not contain enough money to fully prepay the head lease at any particular time, this does not answer all the concerns of a purchaser or lender.

D. Series of head leases

Another way a developer may choose to keep his or her initial land investment costs down while preserving the right to acquire additional lands to complete the development if the market demand is there, is by entering into a head lease and a series of options attached to head leases for land in phases as it would be developed. This permits the developer to fully prepay the land for the initial phase, which creates the security of tenure for the purchaser and financier, while having binding options to acquire leases for subsequent phases as market demand dictates. Because each head lease is separate and fully prepaid when the option is exercised, the concern about the failure of the head lease resulting in losses to the sublessees and lenders is lessened considerably.

E. Long term head lease of a single parcel that permits development in blocks

A variation that incorporates a combination of the above features is a head lease for a very large parcel of land, which permits portions of the development to be subdivided off in blocks as they are developed, and developed either by the original developer or assigned to a new developer by way of a replacement head lease. The advantage of this type of structure is that for projects with a long term build-out, for example 20 years, the terms of the subleases for the final portion of the project will still be 99 years because the term recommences with the registration of each replacement head lease. In order to tidy up the terms of the entire development, the head lease would provide that, upon registration of the last replacement lease, the terms of all of the prior replacement leases and the residual head lease will be extended to the termination date of the last replacement lease, not to exceed a certain date. The marketing advantages of this sort of arrangement are obvious, although it does create further complications by way of multiple homeowner associations within the same development.

F. Long term head lease prepaid by parcels as parcels are subleased

A head lease that requires an initial prepayment, together with payments of rent as each sublease is sold and registered in the Indian Lands Registry, can be very attractive to the developer and to the First Nation as an ongoing source of revenue. It creates less certainty for the purchaser and lender and, therefore, requires modification of the head lease and sublease to build in a safety net. The modified documents permit the portion of the head lease that has been prepaid (that is, the portion upon which the subleases have been registered and sold to third parties) to be subdivided off from the main parcel and assigned to the sublessees through a homeowner corporation or a homeowner association. This safety net feature has been developed and used successfully on Westbank , Kamloops, Invermere and Osoyoos First Nations Lands.

Because of the safety net, Canada Mortgage and Housing Corporation ("CMHC") has agreed to insure the financing of subleases in projects having this structure, which increases the marketability of the projects considerably. The availability of CMHC insurance makes the chartered banks more comfortable in lending, and makes the purchasers more comfortable in purchasing subleasehold interests.

The safety net is created by a provision in the head lease permitting the prepaid lands to be assigned to the homeowner association in the event of a default by the developer. The subleases also provide that each sublessee becomes a member of the homeowner association automatically as he or she purchases a subleased lot.

Negotiating the head lease

In this section, we will deal specifically with the issues that are important to the developer (because of their importance to the end purchasers and lenders) in the negotiation of the head lease.

A. Length of Term

For purposes of both marketability and security of tenure, the longer the term for the head lease, the better. The developers of most residential developments will try to obtain a 99-year lease. Some First Nations will not permit a lease of their lands for more than 49 years.

B. Payment of rent

As discussed above, having the rent fully prepaid either for the entire area covered by the head lease, or at least for the portions as they are subleased with the safety net provisions, will be extremely important to the developer for marketability. If such an arrangement is not possible, then, at the very least, one would want to tie any increases in ongoing rents to the Consumer Price Index, rather than having them set in reference to fair market value at subsequent intervals.

C. Environmental assessments

It is preferable to negotiate so that an environmental assessment is only required on the entire project, rather than on each individual sublease, as is provided in the standard Indian and Northern Affairs Canada ("INAC") leases.

D. Uses

The "Uses" section of the lease is fundamental to the developer's ability to develop on the lands as, in effect, it creates the zoning for the lands and will dictate what can and cannot be done at a later date on the lands. It is important that the "Uses" section be drawn as broadly as possible to permit the developer flexibility as the development proceeds. For lands in First Nations with Zoning Bylaws in place, the Uses section may refer to any uses permitted by applicable laws.

E. Mortgageability of the subleases

The head lease must provide the right for the developer to mortgage the head lease for development financing purposes, and the subleases must permit the sublessees to mortgage the sublease. In order to make the head lease and sublease attractive to lenders, a number of provisions must be included, such as:

(a) prepayment of the rent or the safety net outlined above;
(b) the ability to get notice of and cure defaults;
(c) ensuring that covenants regarding bankruptcy or insolvency of the tenant or other incurable defaults do not result in the termination of the sublessees' and lenders' rights;
(d) provisions relating to application of insurance proceeds must meet the lender's requirements;
(e) the head lease must be assignable in the event of realization;
(f) a provision for the granting of a new lease directly from the landlord to the subtenant when the lease is terminated.

In addition to specific provisions of the head lease and sublease, which will be required by lenders, the lenders may also wish to obtain an agreement between Her Majesty, the First Nation, the developer and the lender, to give the lender privity rights with respect to certain covenants and processes which are in the head lease or sublease.

An important part of ensuring the mortgageability of the lease is to obtain CMHC approval of both the form of head lease and the form of sublease before the forms are finalized, executed and registered. Once the form has been agreed upon between the First Nation and the developer, a draft of it must be sent to CMHC for its legal department's review and approval prior to execution.

CMHC will be looking for the ability of the subtenants to cure defaults under the head lease; the ability of the subtenants to take over control of the portion of the head lease relating to their property in the event of a default under the head lease; provisions relating to CMHC not being required to cure in order to realize on its security; provisions for disposition of insurance proceeds and an agreement to allow assignments to homeowner associations if the default is an incurable default; and that all curable defaults have been remedied. A summary of CMHC's requirements and some suggested clauses are attached as Appendix A to this paper.

Title insurance is now available for certain leases and subleases on First Nations lands. Attached as Appendix B to this paper is an example of the coverage provided.

Development and servicing agreement issues

The First Nation Council has powers similar to a municipality with respect to zoning and bylaw creation. Often, First Nations may not have their entire development approval process and zoning bylaws in place at the time the developer wishes to proceed with its project. For these reasons, it is of the utmost importance for certainty and long-term viability of the project that a development agreement be entered into between the First Nation and the developer. The First Nation can be made a party to the head lease, and certain additional matters can be incorporated into the head lease or a separate development agreement between the First Nation and the developer can be executed.

The following matters should be dealt with in the development agreement:

A. Zoning under the master development plan

To create certainty with respect to uses that are permitted for the lands, a master development plan for the project should be created and agreed to by the First Nation and the developer early on in the process. The master development plan can incorporate zoning types of provisions, such as densities; can expand on the head lease with respect to specific uses; and can build in a degree of flexibility from the developer's standpoint while creating permission to respond to market demands flexibly. The developer may also seek to limit conflicting uses on lands immediately surrounding the project if the surrounding lands are within the First Nation's control.

B. Jurisdictional matters

The developer will also want to ensure that the provisions of its development agreement will govern, even if the First Nation subsequently passes a bylaw that is contradictory to what the First Nation has agreed to under the development agreement. Issues of conflicts between First Nation bylaws and the development agreement and conflicts between the head lease and the development agreement (if separate) should be dealt with in the development agreement.

C. Development approval process

If the First Nation has not yet created a development approval process, the developer may wish to outline in the development agreement what process will be followed in order that the applications for development, subdivision, building and occupancy permits can be dealt with in a certain and expedited way. For the purposes of both administrative ease and cost control, the concept of using "registered professionals" to certify completion of different parts of the project is attractive to First Nations, and can also give the developer some assurance of being able to move ahead in a timely manner, even in the event of administrative delays at the First Nation office.

D. Services and facilities

Prior to commencing any development, the developer will have checked on the availability of services to the lands, and the development agreement should outline who is providing the services, at whose cost, and what happens in the event of interruption of services. In many cases, there are servicing agreements between the neighboring municipalities and the First Nations, which, in turn, the developer may become party to or may derive services under. All of these agreements must be reviewed to ensure that adequate servicing is available for the developer.

E. Parks requirement

The provisions of the Local Government Act, R.S.B.C. 1996, c. 323 relating to dedication of parks as part of a development may be covered in the development agreement. Because the Local Government Act does not apply to reserve lands, the parks requirement will be a matter of agreement between the developer and the First Nation, and the requirement for dedication of land as park or contributions in lieu will be covered in the development agreement.

F. Access requirements

Section 28(2) permits for access from Her Majesty may be required if access to the lands is over any part of First Nation lands. If access is directly from a provincial highway, then an access permit from the Ministry of Transportation and Highways will be required. Agreements relating to access matters may be covered in the development agreement. The development agreement may even contain a requirement by the First Nation to take steps to remove any impediment to access to the lands in the event of a road block or blockade, or at least to request that the RCMP take such steps.

G. Heritage matters

Any First Nations lands that are developed will be subject to a heritage survey prior to commencement of any development. It may be helpful to confirm the exact process that will be followed in the event heritage items are discovered in the course of development, and to predetermine the cost contributions that will be required from the developer for heritage matters.

H. Cost contributions

First Nations can, by bylaw, create development cost charges, and the developer may wish to create certainty for its future costs by agreeing in the development agreement as to exactly what

those development cost charges will be. The developer may also be required to make up-front capital contributions for water systems or other required services infrastructure as part of the development agreement.

I. Latecomer charges

The development agreement can contain provisions for latecomer charges for the benefit of the developer, in the event the developer is required to over-size or upgrade services beyond what is required for its specific development. A modified version of what is in the Local Government Act may be useful for that purpose.

J. Property taxes

A matter of concern to eventual purchasers of on-reserve projects is the amount of property taxes payable. It is possible, in the development agreement, to agree with the First Nation that assessments will be done in a manner comparable with the assessments being done in the adjacent municipality or regional district by the BC Assessment Authority, that the mill rates will be comparable to those of the adjacent fee simple lands, and that a grant similar to the then current homeowner grant will be available to purchasers. For marketability purposes, it is important that the developer, as closely as possible, approximate the effects for the homeowner of owning fee simple land in the immediate market area.

K. Rights of way

The requirement to grant rights of way to utility providers, both internal and external, may be covered in the development agreement. The developer will want to ensure that the First Nation will give rights of way to the utility providers wishing to deliver utilities to the project, and the First Nation will wish to reserve to itself the right to grant permits to utility providers on the project lands if required for future developments beyond the lands.

L. Assignability

This provision may be covered in the head lease, as it is ultimately the assignability of the head lease that is important. If it is not adequately covered there, the development agreement may deal with what consents are required for an assignment of the lands or a portion of them, and what are reasonable pre-conditions to providing such consents.

M. No discrimination

The First Nation will be interested in providing employment opportunities to its members and may ask the developer to make some assurances to provide such employment opportunities. The First Nation may also, if the development contains recreational facilities, wish to ensure availability of those amenities to its members, and the developer needs to be prepared to deal with those requests. The First Nation may also ask the developer to agree not to discriminate against the First Nation's members if they wish to purchase portions of the project.

N. Dispute resolution

To avoid the expense and time delays associated with traditional litigation, and to more closely track the usual First Nations' method of resolving disputes, it is advisable to provide for mediation and arbitration in the event of disputes between the parties.
If a First Nation has a Land Code and Zoning Bylaws, the Development Agreement will be similar to those used by municipalities dealing with DCC's, services and warranties.

Land Codes under First Nations Land Management Act

Some First Nations are moving toward self-government by enacting Land Codes under the First Nations Land Management Act, S.C. 1999, c. 24.
Effective July 1, 2003, Westbank First Nation (WFN) instituted a Land Code which governs transactions dealing with Westbank Reserve Lands (Westbank Lands) and procedures for registrations of instruments affecting Westbank Lands. The Land Code has effect pursuant to the terms of the First Nations Land Management Act. The Land Code replaces the very short provisions in the Indian Act, R.S.C. 1985, c. I-5 which deal with registration of interests in First Nation Lands. The Land Code is now part XI of the WFN Constitution, which came into effect April 1, 2005.
The Westbank Lands continue to be Reserve Lands held by Her Majesty in trust for the use and benefit of WFN and its members. All existing interests in Westbank Lands which have been approved by the Minister and registered in the Indian Lands Registry in Ottawa continue to have the same force and effect in accordance with their terms and conditions. Interests in the Westbank Lands will continue to be registered in Ottawa in a sub-registry of the Indian Lands Registry known as Westbank Lands Register. The Westbank First Nation Lands Office will continue to process the documents in Westbank and provide the approval of the Minister prior to sending them to Ottawa for registration.
The main effect of the Land Code is to take Indian and Northern Affairs Canada (INAC) out of the lands management process to an even greater extent than previously. The Land Code permits the Director of Lands at WFN to approve documents and transactions on behalf of Her Majesty and the Minister. The Land Code has also removed the requirement for approval of WFN Council for a transfer of a subleasehold interest or a mortgage of a subleasehold interest. This should facilitate the processing of transactions as they will not be required to await the next Council meeting to obtain approval.
WFN has developed its own set of forms which are similar to the types of forms used in the Provincial Land Title Office system. The Land Code sets out the procedure to be followed for leases or permits of WFN community lands. The Land Code also permits the registration of financial claims against interests in Westbank Lands such as judgments, certificates of pending litigation, caveats, liens, options and rights of first refusal.
The Land Code also clarifies that a grant, transfer or other disposition of an interest Westbank Lands will be effective on the date the documents are registered in the Westbank Lands Register. An interest in Westbank Lands will not be enforceable unless it is registered in the Westbank Lands Register.
Existing leasehold interests are protected to the extent that a lease may not be cancelled or forfeited unless both parties consent in writing or a court orders the cancellation and the appeal period has expired, or an arbitrator has ordered the cancellation and no appeal has been made. An interest in Westbank Lands cannot be cancelled or forfeited if it will adversely affect an interest in those lands held by a third party.
WFN may expropriate an interest in Westbank Lands for a "community purpose" once Westbank has passed a law setting out the expropriation method, the method of determining fair

compensation, and a procedure for an arbitration to involve disputes. Disputes arising under the Land Code may be determined as the parties agree by mediation, arbitration or other dispute resolution mechanism, or by a court of competent jurisdiction.

The WFN Land Code permits a Locatee to grant a lease directly to a developer, without First Nation or Ministerial approval. The rent for such a Locatee lease is paid directly to the Locatee, rather than to the Minister or First Nation in trust for the Locatee. The developer will still need to deal with the First Nation for development approvals and servicing agreement.

The Land Code is a step toward clarity in dealing with First Nation Lands which preserves existing interests and simplifies transactional processes. It does not yet give First Nation persons the right to freely sell their land or mortgage it in such a way that the land could be subject to seizure by a non-band member.

This information applies as a general rule but may change depending upon the specific circumstances of your own situation. You should consult a lawyer before acting on any of this information.

If you have any questions, please do not hesitate to contact us:

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