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Overview of Legal Matters to be Considered in the Development of Reserve Lands

INTRODUCTION

This paper provides a brief overview of the legal matters to be considered in connection with a for-market development of First Nation reserve lands. The reader should be aware that for-market development of reserve lands involves many complex legal matters, the number and complexity of which may vary significantly between developments, depending on a wide range of variables. For each legal matter discussed below there are exceptions that may or may not be applicable to a particular development. This overview is intended to highlight the main legal matters affecting development on reserve lands and their most common characteristics. This overview is not intended to be an exhaustive consideration of all the legal matters that may arise in a development of reserve lands, which may only be ascertainable as the development proceeds.

OWNERSHIP OF RESERVE LANDS

In Canada, fee simple title to First Nation reserve lands is held by Her Majesty the Queen in Right of Canada ("Canada") for the benefit of the applicable First Nation. Since First Nations do not, as a matter of law, "own" their reserves, a First Nation cannot, itself, grant an interest in its reserve lands, other than to a member of the band (other than a participating First Nation under the First Nations Lands Management Act). An interest in reserve land can only be granted to a non-member in accordance with the Indian Act. Section 28(1) of that Act states that a grant of any interest in reserve land, other than in accordance with that Act, is void. Therefore, any for-market development of the reserve lands of a First Nation must be carried out in accordance with the Indian Act which requires the direct involvement of Canada in that process.

Designation and Other Prerequisites

Before an interest in reserve land can be granted to a non-member, the applicable First Nation must "designate" those reserve lands under sections 38(2) and 39.1 of the Indian Act. A designation must be (1) approved by a majority of the electors of the band in a referendum, (2) recommended by Council to the Minister (the "Minister") of Aboriginal Affairs and Northern Development Canada ("AANDC") and (3) approved by the Minister. The designation process can be lengthy and expensive so the designation should be clear enough in order to receive the electors' and Minister's approval (including the specific lands designated, the duration of the

designation, the revenue to be received and proposed use, such as residential, commercial or industrial use) but general enough so that if plans change a new referendum will not be required (such as identifying a First Nation controlled entity as the lessee with a power to sublease rather than a specific developer who may not be able to complete the development).

Before Canada can grant an interest in lands owned by Canada, there must be an environmental impact assessment of the development under the Canadian Environmental Assessment Act. As well, before the interest is granted on reserve lands, an environmental site assessment or an environmental audit must be carried out, depending on the site history, proposed use and risk factors associated with the site.

AANDC's policy also requires a fair market value assessment to be carried out before granting an interest in reserve lands to determine the value of the interest granted. If actual fair market value is not received by the First Nation as part of the designation, then other benefits from the designation must be realized by the First Nation that are approximate to the fair market value.

Leasehold Interest

The interest typically granted in reserve lands is a leasehold interest. The options available for leasehold interests vary from multiple leases between Canada and each purchaser of an interest in the reserve lands to a headlease between Canada and a First Nation corporation which in turn subleases the lands to the developer who in turn enters into sublease with each purchaser. The advantage of the latter option is the Minister's approval is required only once, whereas the first option requires the Minister's approval of every purchaser's lease. However, the more remote a purchaser's interest is from the original title, the lower the market value is for that interest since each interest is dependent on the lease above it. As an example, if a First Nation corporation has a headlease from Canada and that corporation then subleases to a developer, who then sub-subleases to individual purchasers, those individual purchasers rely on the developer not to be in default under its sublease with the First Nation corporation because if it does, and that sublease gets cancelled, then the individual purchaser's sub-subleases also are cancelled and the individual purchasers lose their interest in the reserve lands. An assessment must be done for each development (and possibly each phase of a development) to determine what the optimum leasing structure is going to be.

Significant Terms

Regardless of whether it is a direct lease, a headlease or a sublease, significant terms must be negotiated, such as the duration ("term") of the lease, permitted uses under the lease, whether there will be a full release of a lessee upon assignment, environmental indemnifications, insurance requirements, termination and renewal and ownership of improvements upon termination. At a minimum, Canada will be a party to the headlease. Canada has a standard form of lease that it uses that may, or may not, be entirely appropriate for a particular development. Any changes to Canada's form of lease will need to be negotiated and agreed to by Canada. This can be a lengthy and expensive process. As well, if a headlease is utilized, the

form of sublease is often required to be included as a schedule to the headlease so this also will need to be negotiated and agreed upon with Canada and a developer.

The term of a lease (or the term remaining) will impact the amount a purchaser (or a subsequent purchaser) is willing to pay. The shorter the term (or remaining term) the less a purchaser will pay. Canada can only grant a lease up to a maximum of 99 years. It may be possible to include a "top-up" provision in a lease that allows the lease to be extended upon an additional payment being made which may have the effect of increasing the initial amount a purchaser is willing to pay.

Rent

Rent under a lease may take a number of forms, such as (1) regular monthly payments with periodic rent reviews, (2) regular annual payments with periodic rent reviews, (3) fully pre-paid with no subsequent payments or rent reviews, (4) partial pre-payment with subsequent regular payments and rent reviews or (5) variations of these various forms. The form chosen will be based generally on the use of the land by the tenant and its fair market value, however, the form negotiated will impact the actual amount a purchaser may be willing to pay, which determines the actual amount available to the First Nation. Rent reviews in residential leases often deter prospective purchasers because no one knows what the future holds. There have been some very negative rent review experiences reported in the media over the past few years where individuals have not been able to afford their increased rents and have lost their homes. Having a fully pre-paid lease eliminates this concern, however, it also eliminates the ongoing guaranteed cash flow regular payments provide to a First Nation.

Operating and Other Common Expenses

If a development includes common property that will have ongoing common or other expenses or if common services are to be provided to some or all individual purchasers, the lease, rent and corporate structure (discussed below) must accommodate these ongoing expenses, not only ensuring they can be collected, but that the infrastructure or services associated with those expenses will indeed be provided and maintained. Development off of reserve lands can access provincial condominium (strata) laws to provide for these common expenses and services, however, these laws do not apply to reserve lands and other structures must be created that mirror those off-reserve for these types of common expenses and services.

Mortgage of Leasehold Interest

Section 89(1) of the Indian Act prohibits the mortgaging of reserve lands or property on reserve. This restricts the ability of a First Nation to access the capital value of its reserve lands to fund development. Section 89(1.1) of the Indian Act does, however, allow mortgaging a leasehold interest granted on designated reserve lands. However, the capital value of a leasehold interest cannot be accessed until the designation is approved and the lease is issued by Canada and registered. Only then can that lease be mortgaged.

Most banks have what are known as "standard mortgage terms" already registered in the provincial land title office which are then made applicable to a particular parcel of titled lands when those lands are mortgaged. A bank's standard mortgage terms will not be applicable to a leasehold interest on reserve lands, since those standard mortgage terms only apply in the provincial land title system. Specific mortgage requirements and documents will likely need to be negotiated and drafted with the applicable lender. Likewise, the lease, or a headlease and each sublease, will also need to be negotiated and drafted to include provisions that allow a bank to step in and correct any breach of the lease by a borrower (so the lease is not cancelled), known as "estoppel" provisions. Other provisions dealing with lease amendments, appointments of a receiver (if the borrower is bankrupt) and to ensure the lease is not terminated on the bankruptcy or insolvency of the lessee will also need to be negotiated with the bank. A lender may also charge a higher interest rate for a mortgage of a leasehold interest in reserve lands, given the nature of the Indian Lands Registry (discussed below) where that mortgage will be registered.

Culture and Heritage Protection

Any development on reserve should accommodate and protect any cultural or heritage features located on the reserve and be respectful of the culture and traditions of the First Nation. An assessment of these features and considerations should be made by knowledgeable members of the First Nation and appropriate requirements negotiated and incorporated into the provisions of the lease.

Easements and Licences

Developments may require roads and utility services, such as water, sewer, electricity, telephone and cable television. A permit or licence for these roads or utilities granted directly by Canada under section 28(2) of the Indian Act will require the form and content of those permits or licences to be negotiated with, and approved by, Canada. The other option is to have provision concerning these roads and utility services incorporated into the lease, however, those roads and services would then be dependent on the lease remaining in good standing. A utility service provider may not be willing to invest in the infrastructure necessary to provide its utility if there is a risk of them losing their infrastructure because of a default under the lease.

Indian Lands Registry System ("ILRS")

An interest in reserve lands can be registered in the ILRS, however, the ILRS has its limitations.

(1) The ILRS is only an "information registry" and, unlike a provincial land title system, provides no certainty of title and no assurances around priority of interests. There is no requirement that interests in reserve lands be registered in the ILRS. Consequently, there is no certainty that an interest registered in the ILRS is valid and has any priority over subsequently registered interests or unregistered interests. This can be very concerning to an interest holder, particularly a lender using a mortgage of a leasehold interest as security on a loan. Much like the old deed of title system, any defect in a previous grant

or transfer serves to defeat all subsequent transfers and interests, leaving the current interest holder with nothing. As an example, let's say individual "A" owns a home and that home is transfered to individual "B", who then transfers that home to individual "C" who then transfers it to individual "D". It is then discovered that it wasn't actually individual "A" who signed the original transfer to individual "B", but someone impersonating individual "A". That means the transfer from individual "A" to individual "B" is void and then so are the transfers from individual "B" to individual "C" and from individual "C" to individual "D" because you cannot sell what you don't own. In this scenario in a deed of title system, individual "D" would lose their home and it would revert back to the real individual "A". The previous defect in title defeats all subsequent transfers. In a provincial land title or "Torrens" system (named after the individual who developed the concept), individual "D" would not lose their home (provided they were not involved in the initial fraud) and the real individual "A" would be paid from an assurance fund to make them whole for their loss. The ILRS does not provide this certainty of title and does not have an assurance fund. Further, in the ILRS, an unregistered interest could take priority over a registered interest. The provincial Torrens system, with its certainty of title and priority of registration, is designed specifically to avoid the type of uncertainty the ILRS creates.

(2) It can take up to six weeks for an interest in reserve lands to be registered in the ILRS. The documents must first be sent to a regional AANDC office which processes the documents and where they are assigned a pending number. Once processed, the documents are then sent to Ottawa for registration where they get a different registration number (which has no correlation to the pending number). AANDC scans the documents and puts them into the ILRS. At that point, the interest holder will be given their registration number. Again, for a lender, they will not have any assurance their mortgage is registered for up to six weeks. This can be very concerning when funds likely had to be released in advance to close the sale. This delay is very different from a provincial land title system where there is same-day registration and the registration numbers are immediately known.

The limitations of uncertainty of title and registration delay often make purchasers and lenders wary of buying leasehold interests on reserve lands. Some of the risk can be mitigated by title insurance to cover defects in title, unregistered interests and the time gap between signing to registration. Many purchasers, however, are not willing incur this additional expense if equivalent fee simple lands, without these limitations, are readily available.

First Nations Commercial and Industrial Development Act (FNCIDA)

A First Nation may wish to consider the benefits of FNCIDA in relation to a development. Canada enacted FNCIDA to create a framework to address the existing regulatory gap on reserves that limits complex commercial and industrial development. This First Nation-led legislative initiative was developed in cooperation with five partnering First Nations: Squamish Nation of British Columbia; Fort McKay First Nation and Tsuu T'ina Nation of Alberta; Carry the Kettle First Nation of Saskatchewan and Fort William First Nation of Ontario. FNCIDA

allows Canada, at the request of a First Nation and under an agreement with the First Nation and the province, to enact a FNCIDA regulation that essentially adopts the provincial regulatory scheme off reserve and applies it to an on reserve development. The certainty of the provincial regulatory scheme increases certainty for the public and developers alike, while minimizing costs to the First Nation by requiring the province to manage the regulatory scheme.

If a First Nation wishes to participate in FNCIDA, it must have a specific development in mind, pass a Council resolution stating its desire to participate in FNCIDA and enter into negotiations with Canada and the province to develop the applicable regulations that allow for that participation. The regulations are development-specific, created in cooperation with the First Nation and the province and are limited to the particular lands in the development.

In 2010, FNCIDA was amended to allow on-reserve commercial real estate development, including condominium developments, to benefit from the greater certainty of title and strata title that a provincial land title system provides. The certainty of title increases investor confidence, making the value of the reserve lands comparable with similar developments off reserve.

RELATIONSHIP WITH THE DEVELOPER

The involvement of a third party developer is often necessary in order to carry out a large commercial, industrial or commercial real estate development on reserve. A developer often has the expertise and capital necessary for such a development that may be lacking in a First Nation. However, the designation process and negotiation of a lease must be completed before a lease can be granted by Canada giving the developer a leasehold interest in reserve lands. Also, a lease must be granted before any development can begin. Developers are wary of investing their own resources in the designation process or lease negotiations when there is no certainty of their success. Neither is there a leasehold interest that can be mortgaged to raise the resources necessary to fund these activities if the First Nation or developer is unable to fund them in their entirety on their own. This restricts the ability of a developer in carrying out any sort of due diligence prior to entering into any binding obligations. Any investment a developer makes in the designation process, lease negotiations or due diligence is at risk of being lost until there is a successful designation and the lease is granted. This legal reality may eliminate some prospective developers from participating at all in a development on reserve lands.

If a developer is prepared to take on those risks, a Letter of Intent between the developer and First Nation is the recommended starting point to settle the major terms of their relationship. Some of these major terms are discussed below.

Corporate Structure

When a First Nation participates in economic development, they should do so in a way that limits their liability and tax exposure. There are a number of different corporate structures available for carrying out economic development with third parties (corporations, general partnerships, limited partnerships, limited liability partnerships and joint ventures). The

optimum structure will depend on the specific development and third party developer involved. These relationships will need to be negotiated and established in a way that minimizes the liability and tax consequences for the First Nation.

Development Costs

Consideration must be given on how expenses will be covered and how any realized profit for the development will be calculated and shared. As mentioned above, a developer may be willing to cover the cost of the designation and lease negotiation process without the security of having a lease in hand. However, once that lease is in hand, there are certain risks facing a First Nation if the development is not carried out as expected. These risks can be minimized, to a certain degree, in the negotiation and drafting of provisions in the lease. The lease can include provision for a penalty paid by the developer for non-development or failing to develop according to an agreed upon schedule. Labour and material bonds can be required to secure construction obligations as well as provision for insurance and reconstruction if the development is damaged prior to its completion.

Management

Participation of First Nation representatives in decision making processes during construction and sales of the development must be considered. First Nation participation can vary between none (where the developer makes all necessary construction and sales decisions) to full participation (where the First Nation has at least equal, if not final, decision making authority). Where a First Nation wishes to be on this decision making participation spectrum will depend on the individual circumstances of each development, the capacity of the First Nation, the extent of their investment in the development and the First Nation's relationship with the particular developer. Political considerations and "optics" may also have a bearing on this matter.

OTHER CONSIDERATIONS

There are a number of other matters a First Nation must consider as it contemplates development of its reserve lands. Some of these are discussed below.

Land Use and Development Approvals

"Zoning" is a law making tool used by governments to manage development on the lands over which it has jurisdiction. Municipalities use their zoning bylaw making powers to create the type of communities their residents wish to live in, with a particular "look and feel", by setting aside residential, commercial and industrial zones with different densities and development requirements. This process is often called "land use planning" for reserve lands. Municipal zoning bylaws and development bylaws are not applicable to reserve lands. This may be an incentive for a particular development on reserve lands that may not be possible on adjacent lands because of municipal zoning bylaws. However, not having a land use plan in place for reserve lands can create a legal vacuum resulting in disjointed and unplanned development resulting in a chaotic or disconnected "look and feel" for the reserve lands. Any development on

reserve lands must be considered within the overall land use objectives of the First Nation for all its reserve lands to ensure the type of community that does develop over time is what the First Nation members want to live in and be a part of.

Surveys and Access

A designation or lease requires a survey to delineate the specific lands covered by the designation or lease. If a survey is not available, this work will need to be carried out as part of these processes. Depending on the configuration of the lands to be designated and leased, access across other reserve lands that are not designated may need to be provided as well. Consideration will then need to be given to having an access permit negotiated and issued by Canada under section 28(2) of the Indian Act (or section 53 if the reserve lands have been designated).

Service Agreements

Any development on reserve lands will likely require electrical, water, sewer, telephone, cable television, waste collection, animal control, parks and recreation, fire protection, policing or other services. Service agreements will need to be negotiated with a neighbouring municipality for those services that cannot be provided by the First Nation itself. Regardless of who provides these services, agreements will need to be negotiated for the development that address the construction, ownership and repair of the infrastructure necessary to provide the services, access to the reserve lands for the construction, maintenance and repair of that infrastructure, the level of services to be provided to the development, any cost recovery from the development for those services with payment particulars and any liability that may arise from providing those services.

Property Taxation

Section 83 of the Indian Act provides First Nations with by-law making authority for real property taxation on reserve. If a First Nation has not enacted the bylaws necessary to exercise this authority, a provincial or neighbouring municipal government may collect property taxes on third party interests on reserve lands. In order to exercise its authority, a First Nation must pass a real property taxation and assessment bylaw, an expenditure bylaw and an annual rates bylaw. All these bylaws are subject to Ministerial approval.

A First Nation may also choose to become a participating First Nation under the First Nations Fiscal Management Act ("FNFMA"). This has the advantage of giving more direct control of property taxation to the First Nation with greater property taxation powers, including enforcement and other related powers, and the ability to require "development costs charges" to provide services to a development or to charge business activity taxes. In order to become a participating First Nation, a Council resolution must be sent to the Minister with a request to be added to the Schedule of the FNFMA after which the First Nations Taxation Commission will work with the First Nation to develop its property taxation laws. Becoming a participating First Nation under the FNFMA also allows the First Nation to access low cost borrowing through the

First Nations Finance Authority if it meets the criteria of the First Nations Financial Management Board.

Integrated Legal Services

In our view, the legal matters discussed in this overview are best dealt with by a single legal service provider that has extensive experience in all these matters. A single legal service provider will ensure a cohesive legal framework is created for the development with its various components integrated efficiently together. As well, a legal service provider for a development on reserve must understand the complexities and nuances of the reserve system under the Indian Act and related legislation. Ratcliff & Company LLP is able to be that single legal service provider with that extensive experience. As can be seen from our website (www.ratcliff.com), we have been assisting our First Nation clients for over 40 years and have dealt with all the matters discussed in this overview extensively and we believe our collective experience on these matters is unparalleled in Canada.

CONCLUSION

If your First Nation is interested in carrying out a for-market development on its reserve lands, we would be happy to discuss with you in greater detail the legal matters set out above and provide you with an estimated range of costs to provide your First Nation with one or more of the above legal services for your development.

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