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# Real Estate Law

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## Agenda - Real Estate Issues

- Partnering
- Construction Lending
- Construction Liens

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## Partnerships 101

- Basics:
  - Two or more people or corporations come together for a common purpose. Usually to make money.
  - Partners share the investment, risks, and returns; usually proportionately.
  - The terms of their arrangement are usually set out in a partnership agreement.
  - Other names: Joint Venture or Co-Tenancy.

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## Partnerships in Real Estate – Why do it?

- Pool talents to be able to leverage combined assets, skills and knowledge to achieve your goal.
- Financial reasons – create value you could not create on your own (ie. expand the pie)
- Mutual Respect - Each partner sees value in the contributions of the other.
- Risk Management – Spread the risk
- Values – A shared purpose at partnership level.

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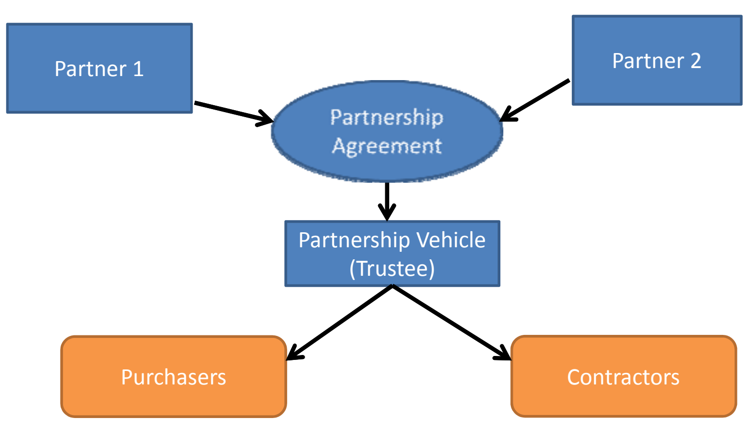
## Partnerships in Real Estate – The Basic form

Partnerships tend to follow a basic format:



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## Partnerships in Real Estate – The Basic form

- Other structural considerations:
  - Adding Limited Partners
  - Liability Protection for debts of the Partnership.
  - Holding vs. Operating Companies.
  - Income Tax impacts of the partnership.
  - Insurance

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## Partnerships in Real Estate – The Agreement

- The Partnership Agreement establishes:
  - Land Value (and transfer if required)
  - Proportionate share of ownership
  - Equity Investment (get credit for advance work)
  - Responsibilities of the partners
    - May differ according to expertise
    - May include fees
  - Management of the Partnership
    - Typically a committee with set responsibilities
  - Distribution of Proceeds

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## Partnerships in Real Estate – The Agreement

- Key items to remember:
  - Understand the role you are playing in the partnership.
  - Understand how the money flows:
    - Value of land
    - Fees
    - Distribution of Proceeds
  - Its all negotiable
    - Proceeds, for example, can "waterfall".
    - Partner may retain some unilateral rights

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## 1. THE CONSTRUCTION LOAN GENERALLY

A construction loan is a short term loan based on collateral that does not exist yet. This is what makes it special:

- It is disbursed as the collateral is created.
- It is used primarily to pay the people who have created the collateral, that is, the Trades.
- Bank needs to know that the value of the collateral exceeds the amount of the loan. It does that by:
  - ⇨ Requiring an Equity Contribution
  - ⇨ Knowing the Project Budget
  - ⇨ Ensuring there is revenue to pay it back (ie. Sales contracts)
  - ⇨ Managing the "Draw" process through a Cost consultant who confirms value in the ground
- It is usually intended to be paid back or "taken out" when the project is complete.

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## 2. THE COMMITMENT LETTER– It's Lawyer Time

- Forms the basic contractual relationship with the Borrower
- Sets out:
  - ⇨ Purpose of the Loan
  - ⇨ Type of Loan
  - ⇨ Pricing
  - ⇨ Repayment
  - ⇨ Conditions
  - ⇨ Security
  - ⇨ Representations and Warranties
  - ⇨ Reporting and Covenants
  - ⇨ Events of Default


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Commitment Letter: Conditions Precedent

- ⇨ Funds not released until ALL conditions precedent are met
- ⇨ Typical:
  - The Commitment Letter
  - Security
  - Satisfactory Appraisal
  - Environmental Studies
  - Equity Contribution (Could be your Contribution Agreement)
  - Engagement of a Project Monitor
  - Housing Services Act Consents in Place;

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## Commitment Letter: Due Diligence

- While the Bank has done economic due diligence by this point, legal due diligence happens during the pre-closing phase:
  - ⇨ Does the Borrower have good title?
  - ⇨ Who is the Borrower? Is the registered owner a Trustee?
  - ⇨ Are taxes paid up?
  - ⇨ Are there any existing liens?
  - ⇨ Does the Borrower even exist?
    - (Quiz: What happens to their land if the Borrower has been dissolved?)
  - ⇨ Are they Bankrupt?
  - ⇨ If the Bank is relying on a revenue steam, is it secure?
  - ⇨ Status of Deposit Lender Term Sheet and release terms;

⇨ **WRAP IT UP IN A BOW**

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## Commitment Letter: Security

- Mortgage
- General Assignment of Rents
- General Security Agreement
- Guarantees
- Undertaking to Complete

$\left.\begin{array}{l}\text{Mortgage}\\ \text{General Assignment of Rents}\\ \text{General Security Agreement}\\ \text{Guarantees}\end{array}\right\}$ Disaster Management

$\left.\text{Undertaking to Complete}\right\}$ Cost Management Tool

⇨Two Species:
- During the Project – undertaking to Complete (Cost Overruns)
- At the end of the Project – Guarantee for Shortfall

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## Commitment Letter: On Going Management

- Read the Commitment Letter
- Conditions Precedent to Subsequent Advances
  - ⇨ Cost in Place Test: Actual Costs less Equity > Outstanding Amount of the Loan
    - Answers Question: Is the money staying in the Project?
    - If your advances to date > the costs, you have a Problem
  - ⇨ Cost to Complete Test: Cost to Complete < Unutilized Portion of the Loan
    - Will we run out of money before the collateral is complete?
  - ⇨ If not met, BANK NOT required to advance
- Note the Control associated with Construction Risk.

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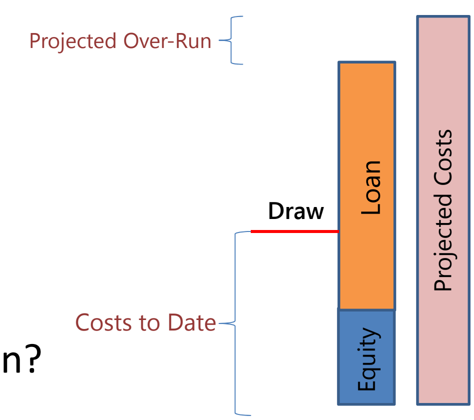
## Application:

Meeting the Tests

Apply the Tests:

1. Met
2. Fail

⇨ What is the solution?



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# 3. CONSTRUCTION LIEN ACT

- **HOLDBACKS**

⇨ CLA operates on the general premise that no one should profit from another's labour. There are three main pillars:

- Liens for trades for full amount of their work.
- a mandatory 10% holdback of all payments (Notional profit) from all trades until all lien matters have been resolved.
- Construction trusts.

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## CLA : Liens Generally

*Who gets a Lien?*

⇨ Every person who supplies services or materials to an improvement for an owner, contractor or subcontractor has a lien for the price of those services or materials.

*When does it arise?*

⇨ On the first supply of services or materials to an improvement

*When is it extinguished?*

⇨ 45 days after the earlier of publication of Certificate of Substantial Completion or the last day of work.

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## CLA : Holdbacks

- The Holdback is security for the construction pyramid and is withheld by the payer – i.e. the Owner.
- Necessary because not all of the subcontractors will have privity of contract with the ultimate payer.
- If the Owner maintains the holdback, it takes the place of the improvement as security for the lien holders. That is, as long as the holdback is not deficient, there is no claim against the asset of the owner and the Holdback could be paid into court in a lien action.

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## CLA : Building Mortgages

- Building mortgage: a mortgage taken with the intention to secure financing of an improvement.
- Construction Loans are necessarily "building mortgages" within the meaning of the Construction Lien Act.
- Bank is ALWAYS behind construction lien holders *to the extent of a deficiency in the holdback.*
- In other words, the mortgage is always behind the lien holders for *about* 10% of the value of the work. **NOT** 10% of the amount advanced.
- Registration date is **IRRELEVANT.**

QUIZ : Why is registration date irrelevant?

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## CLA : Building Mortgages

- **ADVANCING IN THE FACE OF A LIEN**
  - ⇨ Includes receiving Notice of Lien
  - ⇨ You cannot hold back the lien amount claimed and advance:
    - priority lost to all existing and future liens
    - amount of priority lost is amount of the advance, not the lien amount

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## CLA : Release of Holdback

- **MANNER OF RELEASE OF HOLDBACKS**
  - ⇨ Publication of Certificate of Substantial Performance
  - ⇨ Progressive (aka “early”) release of Holdbacks
    - ⇨ **TOTAL** Completion of Subcontracts or Separate General Contracts


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# Basics of Employment Law in Ontario

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## Topics for Today

- There are two ways to terminate an employee:
  - Termination for cause or "just cause"; and
  - Termination without cause.

- A termination of an employee **without cause** occurs when an employer terminates an employee for no reason to do with the employee and his or her performance.

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## Employees Who are Terminated Without Cause

1. The rights of employees who are terminated **without** cause;

2. Strategies to reduce an employer's liability for damages when an employee is terminated without cause; and

3. Circumstances where an employee may be terminated for cause.

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## Employment Standards Act Notice

- The sum of notice pursuant to the *Employment Standards Act* is approximately 1 week of pay for every year of employment to a maximum of 8 weeks.
- A mass termination has its own specific rules.
- These notice periods are required minimums. An employer can provide a longer notice period but may not give anything shorter than the *Employment Standards Act* minimum.

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## Notice at Common Law

Under the common law, notice periods are determined by balancing a number of factors including:

a) the length of service

b) the age of the employee

c) the availability of similar employment

d) the nature of the employment

e) the circumstances surrounding hiring

There is no set rule for determining notice at common law.

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## Severance

In most circumstances, an employee qualifies for severance pay when:

a) their employment is severed;

b) they have worked for the employer for 5 or more years; and

c) the employer has a payroll in Ontario of at least $2.5 million OR

d) the employer has severed 50 or more employees in a 6 month period.

Severance pay is calculated as approximately 1 week for every year of employment, to a maximum of 26 weeks.

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## Mitigation

- All payments under the **common law** are subject to the employee's duty to mitigate.
- This duty means that an employee must try to find alternate employment to reduce the damages suffered.
- If the employee finds alternate employment, any amount earned during the notice period will be deducted from the employee's damages.

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## Ways to Limit an Employer's Scope of Liability for Common Law Damages

- An employment contract is an important tool for employers to minimize their exposure upon employee termination.
- It is very important to obtain legal advice in the process of drafting an employment contract
- It is also important to obtain legal advice in re-visiting old employment contracts.

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## Circumstances Where an Employee May be Terminated for Cause

There are several categories of misconduct which form the basis for just cause to terminate:

1. **Insubordination**
2. **Dishonesty**
3. **Incompetence**
4. **Intoxication**


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# End of Operating Agreements and Taxes

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## End of Operating Agreements and Taxes

***Some Potential Tax Implications***

1. Risk to Status as a Non-Profit Organization (NPO) under the *Income Tax Act*

2. Risk to Eligibility for HST Rebate as Qualifying NPO or Designated Municipality

## Non-Profit Organization Tax Exemption

***Income Tax Act***

149(1) No tax is payable under this Part on the taxable income of a person for a period when that person was...

(l) a club, society or association that, in the opinion of the Minister, was not a charity within the meaning assigned by subsection 149.1(1) and that was organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit, no part of the income of which was payable to, or was otherwise available for the personal benefit of, any proprietor, member or shareholder thereof...

## Non-Profit Purposes

***Canada Revenue Agency's Traditional Approach***

Interpretation Bulletin IT-496R (August 2001)

VERSUS

***Judicial Interpretation of para. 149(1)(l)***

BBM Canada v. The Queen (2009); Canadian Bar Insurance Assn. v. The Queen (1999); and Gull Bay Development Corp. v. The Queen (1984)

VERSUS

***Canada Revenue Agency's More Recent Approach***

CRA Interpretation Bulletins: 2009-0337311E5; 2010-0386301C6; and 2012-0455501I7

## Public Service Bodies (PSB) Rebate

***Recovery of HST Through ITCs***

- GST/HST paid by registrants to make **taxable supplies** recovered through input tax credit (ITC) system
- GST/HST paid to make **exempt supplies** (e.g. long-term residential accommodations) not recoverable as ITCs

***Recovery of HST Through Rebates***

- Eligible Purchases and Expenses of Qualifying NPOs
- RGI Housing Expenses of Providers with Municipal Designation

## Public Service Bodies (PSB) Rebate

***Rebate Rates***

| Designation | Federal Portion of HST Rebate | Provincial Portion of HST Rebate | Total Rebate |
|---|---|---|---|
| Qualifying NPO | 50% | 82% | **69.7%** |
| Designated Municipality | 100% | 78% | **86.5%** |

## Public Service Bodies (PSB) Rebate

***Qualifying NPOs***

- Government funding comprises **at least 40%** of total revenue

$$\textbf{Level of Government Funding (Percentage)} = \frac{\textbf{Government Funding}}{\textbf{Total Revenue}}$$

1. Perform calculation for **current year**
2. Perform calculation for **prior year** (for NPOs in second fiscal year) <u>or</u> **two preceding years** (for NPOs in third fiscal year or later)
3. Compare (1) and (2) - **Greater** percentage used to determine if Qualifying NPO threshold is met

## Public Service Bodies (PSB) Rebate

***Government Funding Includes***

- Identifiable monies (including forgivable loans) paid to support the NPO's objections by:
  - ✓ governments (federal/provincial/municipal);
  - ✓ government-controlled corporations established with main purpose of funding charitable or non-profit activities;
  - ✓ government-established boards/commissions/bodies with main purpose of funding charitable or non-profit activities;

**Level of Government Funding (Percentage)** $=$ $\dfrac{\textbf{Government Funding}}{\textbf{Total Revenue}}$

***...but Does Not Include***

- Non-financial forms of assistance
- Low interest loans and loan guarantees
- Property/services supplied at a subsidized price
- Refunds, rebates, credits, or remissions of taxes, duties or fees

## Public Service Bodies (PSB) Rebate

**Level of Government Funding (Percentage)** $=$ $\dfrac{\textbf{Government Funding}}{\textbf{Total Revenue}}$

***Total Revenue Includes***

$$\left.\begin{array}{l}\text{• Government funding}\\\text{• Interest, dividend, and trust income}\\\text{• Non-arm's length loans}\\\text{• Share issuance proceeds}\\\text{• Other capital contributions}\end{array}\right\}\ 100\%$$

$$\left.\begin{array}{l}\text{• Gifts and donations}\\\text{• Receipts from sales of goods/services}\\\text{(taxable or exempt)}\end{array}\right\}\ 75\%$$

## Public Service Bodies (PSB) Rebate

***Eligible Purchases and Expenses***

- Operating expenses for which an ITC cannot be claimed
- Property/services used, consumed, or supplied in exempt activities
- Property and services acquired to provide long-term (one month or more) residential accommodations, but **only if more than 10%** of the accommodation is restricted to:
  - ✓ Seniors;
  - ✓ Youths;
  - ✓ Students;
  - ✓ Individuals with a disability; or
  - ✓ Qualifying individuals with limited financial resources

## Public Service Bodies (PSB) Rebate

***RGI Housing Provider Designated as Municipality***

1. Charity, co-operative housing corporation, NPO, or public institution;
2. Supplies self-contained, long-term rental accommodation
3. More than 10% of units supplied on RGI basis
4. Receives government or municipal funding

- Municipal rebate applies only to HST paid on expenses relating to supply of RGI housing

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