Foreign Investment in Canadian Real Estate

by GEORGE M. VALENTINI & ADRIAN HARTOG

There are several legal structures available for investment in Canadian real estate. Understanding the principal issues involved in acquiring, leasing, financing or developing a property in Canada will assist a foreign investor in properly assessing the risks and rewards associated with any proposed investment.

The provinces have primary responsibility for property law in Canada. In all provinces except Québec, property law has developed through the English common-law process. In Québec, property law is governed by the Civil Code of Québec (which is derived from the Napoleonic Code.) There is no constitutional protection for property rights in Canada. Consequently, property can be expropriated by government and quasi-governmental authorities, but, appropriate compensation must be paid.

Interests in land are generally held directly in fee simple or by leases as leasehold interests. Condominium or strata title ownership is also common throughout Canada. All provinces maintain a system of public land titles registration whereby ownership can be verified and through which interests in land are registered.

Investment Vehicles

There are several legal structures available for investment in Canadian real estate, including a general partnership, a limited partnership, co-ownership (commonly known as a “joint venture”), a corporation, a trust, personal ownership or any combination of the foregoing. The choice of an appropriate investment structure will be governed by factors such as tax planning requirements, liability issues and business considerations and each foreign investor’s rules and regulations. (For more information, see Chapter 02, “Forms of Business Organization in Canada,” starting on page 10.)

Acquisitions

The first document in any real estate acquisition is normally the Agreement of Purchase and Sale between the purchaser and the
vendor, although this is often preceded by a non-binding letter of intent which sets out the major business terms which have been agreed upon. This agreement should contain all necessary business terms for the transaction, including the description of the land, purchase price, deposit (if any), closing date and any other special terms. This agreement also typically contains conditions for the benefit of the purchaser and/or vendor, as well as representations and warranties by the vendor and, to a lesser extent, the purchaser.

Due Diligence
Once the Agreement of Purchase and Sale is signed, it is generally the responsibility of the purchaser (usually through counsel) to conduct due diligence concerning the property being acquired. This includes title and zoning searches and a review of any leases and surveys of the property. An independent engineering review of the property with respect to environmental and physical matters (particularly property with older buildings) is commonly conducted.

Title Insurance
The purchaser’s counsel may provide a title opinion to the purchaser, although title insurance similar to that available in the U.S. is available throughout Canada and is quite commonly obtained in real estate transactions. With title insurance, the purchaser relies on the policy for its confirmation of title, not on a lawyer’s title opinion.

Leasing
Ground Leases
Property may be leased as well as purchased. One form of leasing arrangement is a long-term ground lease, in which a tenant leases vacant land and develops it. Once the development is complete, the ground tenant sublets space to retail, office or industrial tenants, depending on the type of development. Ground leasehold interests may be bought and sold in a manner similar to fee simple property interests.

Commercial Leasing
Most commercial office and retail space, and much of the standard industrial space in Canada, is available only through a commercial lease. Most commercial lease transactions start with an agreement to lease, although this is often preceded by a non-binding letter of intent. An agreement to lease is typically a binding agreement that contains the business terms agreed upon by the parties, including the space, term, rent and any tenant inducements. Commercial leases in Canada are typically on a net/net rental basis, which requires a tenant to pay basic rent plus a proportionate share of the realty taxes, insurance, utility and other maintenance charges for the commercial building. In a retail lease, a tenant may also be required to pay rent based on a percentage of its annual sales.
Residential Leasing
Residential leases are regulated by provincial legislation. In some cases, the applicable legislation will override the terms of the lease agreement, regardless of the intention of the parties. In some provinces, the ability of the landlord to increase residential rents is limited by provincial regulation.

Financing
Most real estate financing is arranged through institutional lenders such as banks, trust companies, pension funds, credit unions and insurance companies. Credit terms will vary from institution to institution and will depend on the nature of the transaction and the risks involved.

Interest Rate
Interest rates on real estate financings can be either fixed for a specified period of time or variable, based on a “prime rate” set by the lending institution on a periodic basis. The prime rate is based on a rate announced by the Bank of Canada from time to time. A borrower may consider borrowing in other currencies and has a choice of interest rate pricing, including applicable Government of Canada Bond Rates, the London Interbank Offered Rate (LIBOR) and bankers’ acceptances. Certain fees, such as commitment and processing fees, are normally charged by lenders. Typically, it will be the borrower’s responsibility to pay for all of the lender’s legal and other costs in arranging property financing.

Primary and Collateral Security
Lending institutions typically take both primary and collateral security in real property and related assets to secure the loan. Typical primary security includes a mortgage or charge, a debenture containing a fixed charge on real property or, in some cases where more than one lender is involved, a trust deed securing mortgage bonds or debentures and including a specific charge over real property. Collateral security often includes assignments of leases and rents, general security agreements and personal guarantees.

Foreign Lenders
Because many foreign lenders in Canada are subsidiaries of the world’s major banks, they typically participate by way of syndicated loans which are often arranged by major Canadian lending institutions. Whether through a syndicate or directly, foreign lenders may be subject to certain withholding and other forms of taxes on the interest paid to them.

Environmental Concerns
Canada has many detailed laws concerning the protection of the environment. These laws attribute liability for environmental damage to the owner of land and to polluters.
A property owner has certain duties in connection with the discharge of contaminants and hazardous materials into the environment from its property. Note that liabilities associated with improper waste management practices can be inherited by subsequent owners of a property. See also the discussion in Chapter 14, "Environmental Law in Canada," starting on page 68.

Environmental Risk Assessment

A purchaser should assess the environmental risks associated with a property being purchased. In Canada, government officials do not "certify" that a property is free from such risks. A property’s environmental status can be ascertained by inspecting applicable company and public records. In virtually all cases, a purchaser will want to do an "environmental audit" of the property which may include conducting scientific testing and a technical analysis of the property. Lending institutions often require such an audit before advancing any funds.

Development Controls

Property development is provincially regulated, primarily at the municipal level. Municipalities typically control land use and the density of development through official plans and zoning by-laws. Many of them impose development charges on new developments within their jurisdiction. Several provinces restrict and regulate the ability of an owner to subdivide property.

Construction of new projects is also subject to provincial and municipal legislation. In addition to regulating the maintenance of existing structures, building codes set specific standards for the construction of buildings. Before construction commences, most municipalities require that building permits and all regulatory approvals be obtained.

Real Estate Brokers Legislation

Generally, a person who wishes to dispose of or acquire real estate will seek the assistance of a real estate broker. Real estate brokers are subject to special regulation in Canada. Each province has legislation that regulates the trade in real estate. Such regulation is designed to better protect consumers and instill confidence in the buying and selling of real estate.

In Ontario, the Real Estate Council of Ontario (RECO) is responsible for regulating trade in real estate and administering the Real Estate and Business Brokers Act, 2002 (REBBA), which came into force on March 31, 2006. Under REBBA, all brokerages, brokers, salespersons and any person involved in the trade in or of real estate must be registered with RECO. Members of RECO accept a Code of Ethics that forms part of the legislation and defines how members are
to conduct themselves in doing business in Ontario. RECO can lay charges under the statute, and its Registrar has the authority to propose, revoke or put conditions on a broker’s registration. RECO provides for a complaints, compliance and discipline process to ensure that effective action is taken in instances where a RECO member has acted in an unethical manner.

**Mortgage Brokers Legislation**

As with real estate brokers, mortgage brokers, lenders and administrators are subject to specific regulations in Canada. These regulations are governed by various pieces of provincial legislation. In Ontario, the *Mortgage Brokerages, Lenders and Administrators Act, 2006* went into full effect in 2008. The Act requires all mortgage brokerages, administrators, brokers and agents to obtain a licence to do business in Ontario. Similar legislation either exists or is under consideration in most of the other provinces.

**Land Transfer Taxes**

Land transfer taxes are imposed on the transfer of real estate in some provinces. The amount of tax payable will vary based upon the value of the consideration paid for the real estate. Certain leasehold and other interests in land may be exempt.

---

**Osler’s Real Estate Group understands the many forces that come into play in today’s increasingly complex and sophisticated commercial real estate market. George Valentini and Adrian Hartog are partners in our Group.**

**George Valentini**

gvalentini@osler.com

416.862.6649

**Adrian Hartog**

ahartog@osler.com

416.862.6543