

**HUMBER REAL ESTATE EXAMS**

**MiniCram®  
REAL ESTATE  
LICENSE EXAM**

**4**

**STUDY NOTES**

**COMMERCIAL  
TRANSACTIONS**



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## MiniCram® Real Estate Exam Study Notes

### Course 4 – Commercial Real Estate Transactions

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## INTRODUCTION

Dear Reader,

Congratulations on purchasing our **MiniCram®** for Ontario Real Estate License Exam preparation. The purpose of this book is to provide you with last minute review of important theory and math concepts for the exam. **MiniCram®** has compiled this booklet so that you can focus on key areas of study as well as prepare to overcome the most common mistakes that students make on the actual test day.

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### We Want to Hear from You

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## 1. INTRODUCTION TO COMMERCIAL REAL ESTATE

### 1.1 Commercial Real Estate

#### Commercial Real Estate Environment

- Commercial real estate transactions are more complex than residential due to the fact that they are time consuming, need more information, and may involve high-profile projects that involve complex negotiations.
- Transactions take longer to develop and require extensive research but also offer high remuneration.
- The working environment is different than residential due to types of properties, specific needs of buyers and sellers, building construction techniques, reliance on third-party professionals, financial statements, etc. are some of the factors.
- Transactions also involve buying and selling businesses and commercial leasing, where the negotiations may require specialized knowledge and skills.
- Education and Experience: Due to complexity of commercial transactions, working experience and/or post-secondary education in related disciplines is an asset.
- Financial Literacy: Since commercial clients are business and investment savvy, commercial brokerages usually seek those salespersons who have financial education or background.
- Working Hours: Unlike residential real estate, commercial real estate, mostly occurs during normal business or office hours.

#### Working with a Commercial Brokerage

- Brokerages may hire salespersons as 'employees' or as 'independent contractors', but this difference is only for tax purposes.
- REBBA treats both *employees* and *independent contractors* as employees of the brokerage.
  - *Employee*: The contract of service *exists*, the employer controls and supervises the work of the employee.
  - *Independent Contractor*: The contract for service is *created*, and the duties and responsibilities of each party are defined in the contract.
  - The salesperson is responsible for his own taxation matters but has more control over managing his real estate business.
- In a commercial real estate brokerage, a new salesperson is likely to start as a trainee or an employee for gaining knowledge and experience.
- When looking for a brokerage, it is important to check their training programs, the remuneration split, and expenses, such as desk fee, provision of working space, and any special services that are unique to the brokerage.

#### Seller Representation Agreement – Commercial (OREA Form 520)

- The *Seller Representation Agreement (Listing Agreement)* establishes an agency relationship between the seller and the brokerage.

- It sets out terms and conditions, outlines services, and provides details of the property.
- Differences in Residential and Commercial Clauses: The wording of certain clauses in commercial listing agreement is different than residential Listing agreement.
  - *Definitions and Interpretation*: This clause is expanded to include an *Option to Purchase*, exercising a *First Right of Refusal*, and sale or transfer of shares or assets.
  - *Commission (Remuneration)*: This clause includes a provision that if the deposit is forfeited, awarded, directed, or released by the seller, the listing brokerage would retain 50% of that amount for services it has provided.
  - *Indemnification and Insurance*: This clause includes liability, claim, loss, cost, damage, or injury resulting from contamination or environmental problems. The seller warrants that the property is insured against any claims or lawsuits resulting from bodily injury or property damage to others.

### Buyer Representation Agreement – Commercial (OREA Form 540)

- The *Buyer Representation Agreement* establishes an exclusive agency relationship between the buyer and the brokerage for locating a suitable property for the buyer.
- It sets out duties and responsibilities of both parties and details remuneration arrangements.
- Differences in Residential and Commercial Clauses: The wording of certain clauses in commercial buyer representation agreement is different than residential buyer representation agreement.
  - *Definitions and Interpretation*: This clause is expanded to include an option to purchase, and sale or transfer of shares or assets.
  - *Services Provided by the Brokerage*: This clause relates to specific services provided to the buyer and has space for other services.
  - *Responsibilities of the Buyer*: This clause details specific duties of the buyer to the brokerage during the term of the agreement.

### Terms of the Agreement

- REBBA requires that every representation agreement must be reduced to writing, signed by the salesperson, and presented to the party (seller or buyer) for signing.
- The agreement must include the date of commencement and a definite date of expiry.
- If the agreement is for more than 6 months, the party's written consent and initials must be obtained.
- Copies of signed agreements must be delivered *immediately* to the party.

### Offers and Negotiations

- Since commercial transactions are complex, salespersons should advise their clients to obtain expert advice from third-party professionals.
- These include accountants, lawyers, land planners, environmental engineers, lenders, architects, tax specialists, appraisers, structural engineers, etc.

- Additional Complexities: It is important for salespersons to stay up to date on trends and upcoming changes, such as need for landfill or a plan for a new road.
  - Larger brokerages may have a team of several professionals within the brokerage while smaller brokerages usually hire third-party professionals.
  - Transactions may take longer than usual to close due to the time taken for completing due diligence.
  - Some brokerages keep listings internal due to client confidentiality issues and others use *Confidentiality Agreements* to protect their clients.
  - Commercial properties may be owned by corporations, partnerships, or a *Real Estate Investment Trusts (REIT)*.

### Due Diligence

- Scope of Analysis: There is no standard clause for due diligence because client needs vary, and clauses are customized depending on the type of property.
  - The ultimate goal is to have full knowledge of relevant facts and a team of accounting, legal, and other professionals may be involved to assist the buyer.
- Time Period: Commercial agreements usually provide 30 days or more to the buyer to satisfy conditions.
  - The buyer is given wide-ranging access to documentation and information from the seller and may terminate the agreement if the facts discovered do not meet buyer's expectations.
- Financial/Operational: Financial due diligence involves review of financial documents, such as income/expense statements, balance sheets, rent rolls, bank statements, tax bills/returns, employee records, and operating costs.
- Legal: Legal analysis of the property involves review of property title, major assets, existing mortgages, surveys, licenses, permits, contracts, and zoning compliance.
- Structural: Commercial building inspections include visual inspection, review of relevant documents, identification of physical deficiencies, photographs, and a detailed summary.
  - The report covers items such as building envelope, structural design, mechanical systems, electrical systems, interior finishes, and life safety systems.
  - The inspection may reveal certain material defects and deferred maintenance.
- Environmental: An *Environmental Site Assessment (ESA)* report may be required to assess the overall environmental condition of the property because hazards and contaminants pose a significant risk.

## 1.2 REBBA and Commercial Tenancies Act

### Disclosure Requirements

- Most *Errors and Omissions* claims originate from inaccurate or incomplete information.
- Litigation occurs when buyers discover material defects that were not disclosed to them.
- REBBA requires that salespersons protect their clients by identifying and disclosing material facts and providing competent and conscientious service.



- Seller Protection: Taking adequate time to fully investigate the property, fully discussing their obligation to disclose, asking questions instead of making assumptions, and immediately resolving issues as and when they arise.
- Buyer Protection: Advising them to fully investigate material facts, including appropriate conditions in the agreement, and encouraging them to seek third-party expert advice.

### REBBA and Salesperson Activities

- Record Keeping: Brokerages are required to maintain all original records related to commercial transactions at a location specified by the Registrar of RECO.
- Recommending Third-Party Advice: Salespersons should encourage their clients to obtain services of third-party professionals when they do not have sufficient knowledge, skills, judgment, or competence in any matter.
- Working with Assistants: Brokerages must ensure that trading activities are performed by registered salespersons and unregistered assistants or staff is only for support functions.

### Commercial Tenancies Act

- The *Commercial Tenancies Act* outlines the rights and obligations of the landlords and tenants in a commercial tenancy.
- A commercial tenancy involves lease of a property, which is principally used for carrying out any business activity.
- This Act does not provide for any standard, government issued lease.
- The precise wording of a signed lease takes precedence over the Act on matters such the rents, operating costs, and leasehold improvements.
- Landlord's Rights and Obligations: Landlord must notify the tenant in writing regarding any breaches of lease and allow time to the tenant to comply.
  - If the tenant fails, the landlord has the right to terminate the tenancy.
- Tenant's Rights and Obligations: Tenants must fulfil their obligations specified in the lease and pay rent on due dates.
  - Tenants cannot stop rental payment if the landlord does not fulfill lease obligations.
- Disputes: Any party may approach a *Small Claims Court* (for damage up to \$35,000) or the *Superior Court of Justice* for resolving their tenancy related disputes.

## 1.3 Building Code, Planning Act, and Zoning Bylaws

### Ontario Building Code

- This regulation, under the *Building Code Act*, sets out minimum standards for building design, provisions for safety, fire protection, and structural sufficiency.
- The *Ministry of Municipal Affairs and Housing* enforces the Act and amends it every 5 years to reflect changes in technology and public safety issues.

- **Building Code Regulations:** The Act addresses specific uses, occupancy requirements, acceptable fire and safety standards, means of exit, accessibility, service facilities, and acoustic separation.
  - Structural loads, foundations, and design requirements for structural materials as well as wind, water, and vapour protection.
  - Heating, ventilation, and air-conditioning systems.
  - Plumbing for water supply, drainage, and non-potable water systems.
- **Building Permits:** No person can construct or demolish a building unless a building permit is obtained from the local municipality.
  - Permit is not issued if the proposed construction activity is not in compliance with the *Ontario Building Code*.
- **Building Permit Process:**
  - **Application:** The application is submitted to the local *Building Department* along with plans, survey, and application fee.
  - **Review:** Application is reviewed for conformation to zoning bylaws, HVAC, plumbing, and architectural/structural requirements.
  - **Permit:** The permit (legal permission to start construction) and approved plans must be posted on the construction site.
  - **Inspections:** Requests for inspections must be made within 24 hours before work proceeds to the next stage as given in permit. Failure may result in work stoppage order.

### **Municipal Planning**

- The provincial *Planning Act* is the statutory framework that regulates orderly division, development, and permitted use of land.
- *Provincial Policy Statements* relate to management of efficient and cost-effective development, land use patterns, protection of environment, and public health.
- Municipalities are authorized to prepare, implement, and revise *Official Plans* for long-range development and zoning bylaws to set building structural standards and their use.
- **Upper Tier (Regional) Municipality:** Responsible for preparation, adoption, and revision of the Official Plan (long-range), and division and development of land.
- **Lower Tier (Township) Municipality:** Responsible for preparation, adoption, and revision of the Official Plan (long-range) and various zoning bylaws.

### **Impact of Planning Act Commercial Development**

- **Zoning Bylaws:** Zoning bylaws set out permitted uses, building structural standards, such as minimum setbacks and coverage, and other regulations related to signage, noise control, and parking.
  - They regulate the type of construction, minimum elevation of door and windows, loading or parking, and minimum density provisions.
  - Other regulations include placement of signs and their size, flood control provisions, construction of fences, and energy conservation programs.
  - Municipal officials have the authority to enter private lands to inspect the discharge of waste into municipal sewage system.

- Non-Conforming Use and Zoning Amendment: Bylaws provide for flexibility and owners/buyer may seek a *Minor Variance* if their proposed use does not generally conform to current zoning.
  - Owners may also apply for a zoning amendment if the proposed use aligns with the *Official Plan*.
  - An owner may also apply for approval of continuation of a *Non-Conforming Use* when the current use existed before passage of the current zoning bylaw.
  - However, the non-conforming use must be continuous, and any interruption would make the use as non-compliant or non-conforming.
  - Salespersons must be aware of zoning bylaws and advise their buyer clients to contact local municipality before making an application.
- Site Plan Control: This is imposed at the time of planning and development to influence the building design and site amenities.
  - The developer is usually required to provide amenities over and above the zoning requirements and include items such as landscaping, traffic flow, trash collection, tree plantation, etc.
  - Approved plans of a commercial developer require the developer to enter into a *Site Plan Control Agreement*.
  - This is to ensure that the proposed work is in accordance with the approved plans and satisfaction of any conditions set out by the municipality.

## 1.4 Commercial Investment Properties

### Office Building Classifications

- Class A: These are premium buildings in prestige locations with high-tech systems and high-quality finishes.
  - They are typically occupied by banks, international corporations, and large legal firms.
- Class A+: This landmark property is located in highly desirable sub-market, is designed by some recognized architect, and features high-end furnishings.
  - These buildings have higher rent, and 80% or more space is occupied by institutional investors.
- Class B: These buildings are found in good locations, have average building materials and construction, they are well maintained, and have adequate internal systems.
- Class C: These buildings are found in less desirable locations, may need renovations, and may not have modern technology systems in place.
  - The advantage is that they offer low rents and are affordable in comparison to Class A or Class B buildings.

### Retail Properties

- Some retail property types include big box stores, power centres, shopping centres, lifestyle centres, downtown shopping malls, outlet malls, and main street retail.

- Retail stores also include a diverse mixture of neighbourhood stores, chain, discount, independent, luxury, and departmental stores.
- Analysts track a variety of dynamic business aspects including change in demographics, economic trends, merchandising methods, retail site selection, target markets, distribution methods, and shopper preferences.
- Retailers often face tough competition from online distribution centres, which forces retailers to make design improvements and greater customer service standards in order to retain customers.

### Industrial Properties

- Industrial market includes vacant land and buildings used for manufacturing (production), storage (warehousing), and distribution of commercial goods and services.
- Salespersons must be aware of terminology used for industrial processes, such as fabrication, production, packaging, warehousing, and distribution.
- Investor vs. User: *Investors* need large and long-term and credit-worthy tenants while *Users* are inclined more towards high capital costs for their manufacturing needs.

### Multi-Residential Properties

- Multi-residential real estate refers to any residential structure that has more than one dwelling unit.
- Smaller residential buildings such as duplexes, triplexes, fourplexes, etc. are excluded.
- This market is mainly driven by supply and demand, which is a complex interplay of economics, demographics, and target market preferences.
- The *Residential Tenancies Act* regulations also influence the multi-residential market.
- Market Analysis:
  - *Economy*: Rising income levels dictate potential price points for various types such as studio, one, two, and three-bedroom apartments.
  - *Demographics*: *In-migration*, *out-migration*, and overall population growth also help in analysis.
  - *Preferences*: Proximity to schools, transportation, and nearby retail services, as well as amenities in the building also attracts people.
  - *Competition*: Analysis of existing competition, as well as new buildings currently approved or under construction.

### Farm Properties

- The term *agriculture* refers to the production of goods through *farming*, which is defined as-
  - The production of field-grown crops, cultivated and uncultivated, and horticultural crops.
  - The raising of livestock, poultry, and fur-bearing animals.
  - Production of eggs, milk, honey, maple syrup, tobacco, fibre, wood from wood lots and fodder crops; and
  - The production or raising of any other prescribed thing or animal.
- Farm properties may range from a small few acres farm to a larger farm spanning hundreds of acres.

- Farms are classified as small farms, farm co-ops, viable farms, and recreational farms.
- Valuation: Valuation of farm properties depends on location, land, buildings, and other assets.
  - Value is also impacted by factors such as proximity to large urban areas, rural amenities, and type, age, and condition of farm structures and farming equipment.
  - Farm marketing boards, farm quotas, and production contracts can also impact value.

### Recreational, Hospitality, and Institutional Properties

- Recreational: This category includes a large array of properties such as wilderness camps, bed and breakfast (B & B) accommodations, ski chalets, trailer parks, marinas, campgrounds and larger hotels, motels, and lounges.
  - Boating and water sport activities are a major attraction for these properties.
- Hospitality: These properties serve the vacationing public and include large resorts, hotels and motels, boutique hotels, lodges, and resorts.
- Institutional: Banks, schools, universities, hospitals, insurance companies, religious or charitable organizations, municipal, and/or other government buildings.

### Vacant Land

- This segment is focused on development activities involving planning, application, and development processes, which are regulated under the provincial *Planning Act*.
- Brownfields Land: These properties are abandoned, contaminated, or under-utilized, which need cleanup and revitalization.
  - The *Ontario Brownfields Statute Law Amendment Act* facilitates development of such properties by providing certain incentives such as providing financial assistance and limiting future environmental liability, potential legal, and financial risk.
- Greenfield Land: Greenfield land refers to undeveloped land within an urban or rural area used for agriculture or landscape design and to evolve naturally.

### Mixed-Use (**Commercial-Residential-Retail**)

- Single Master Plan: Mixed-use developments involve three or more standalone, profit making uses such as retail, office, residential, entertainment, etc.
- Live-Work Properties: This concept appeals to professionals in creative and tech industries who can use the space as a workplace and as living accommodation.
- Complex Design: Proper planning and integration of diverse uses is critical for mixed-use developments and may include even big box stores.

### Commercial Ownership Options

- Sole Proprietorship: *Sole Proprietorship* is a business undertaking owned and managed by a single person, who is responsible for all debts, is entitled to profits but is also liable for all losses.
  - The benefit is that the business operation can be started immediately with little paperwork, start-up costs are low, and tax advantages also exist.
  - Disadvantages include limited capital investment that results in low borrowing power, unlimited liability in case of bankruptcy, and right of creditors to seize personal assets in the event of default.
  - There is no separation between personal income and business income.
  - Sole proprietorship lacks continuity because after the death of the person, the business would be dissolved.
- Partnership: *A Partnership* involves two or more individuals or entities who undertake a business operation for the purpose of making a profit.
  - Each partner is personally responsible to report the profits or losses for taxation purposes.
  - *A Partnership Agreement* is signed and is governed under the *Common Law*.
  - Partnership is personal in nature and all partners are *jointly and severally* liable for the actions of one another.
- Limited Partnership: *A Limited Partnership* limits a partner's liability to the amount invested and profits shared.
  - There must be at least two partners - one *General Partner* and one *Limited Partner*.
  - The *General Partner* operates the business and has unlimited liability.
  - The *Limited Partner* is a *passive investor* whose liability is limited to the investment.
- Corporation: *A Corporation* is a legal entity established after registration of an *Article of Incorporation* under the *Corporations Act*.
  - Ownership of a corporation is by way of shares and these shares can be sold or transferred.
  - It provides a legal separation between the business operation and its owners (*Share Holders*).
  - Corporations may be merged into a single corporation and a single corporation may be split to create subsidiary corporations.
  - The liability of shareholders is restricted to the value of shares held as given in the *Article of Incorporation*.
  - Debts of the corporation are distinct from the shareholders unless an agreement is signed for personal guarantee or liability.
- Trust Ownership: In a Trust relationship the *Trustor or Settlor* gives property or assets to the *Trustee* by means of an agreement.
  - The *Trustee* manages the property or assets for the benefit of a *Beneficiary*.
  - Family trusts may defer tax liability by transferring trust assets from one generation to another.
- Joint Venture: Involves a real estate project started by a group of investors in order to share profits or losses.

- Each member is assigned a proportionate share of the assets/liabilities based on the investment and each member can calculate income individually for tax purposes.
- No investor can individually control the project and the life of the *Joint Venture* is limited to the project life.
- An undivided interest exists in the project, which means that no specific part or unit is assigned to any investor.
- *Canada Revenue Agency* has not given any formal tax status to *Joint Ventures* and a formal *Business Number* is not assigned.

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