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Carters Spring Charity and Not-for-Profit Law Webinar

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Leasing 101: What Charities & NFPs Need to Know Before Signing

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2

REAL PROPERTY IS IN SHORT SUPPLY...



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3

A. ARE YOU SIGNING A LEASE OR LICENSE?

1. Property Rights

License:

A personal right between the licensor and licensee, *i.e.* the licensor does not receive any interest in the property


Lease:

Confers an interest in the property, *i.e.* a property right, binding on the property owner and on other persons

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4

- *Example:* I own land and give you the right to use and occupy my building
 - If occupation is via *license*, then when I sell the property to a third party, you cannot enforce a personal right (between me and you) against that third party
 - If occupation is via *lease*, the property right is capable of binding the third party purchaser
 - If your lease is registered on title, it would be binding on the third party purchaser



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Say hello to your new landlord



2. Nature of Possession

- Lease:
- *Generally confers exclusive possession for tenants*
 - *i.e.* tenants are given “quiet possession” of the leased premises, to the exclusion of others including the landlord, subject to certain terms
 - Terms of lease may provide situations where landlord can enter premises, e.g. to make emergency repairs or on tenant default
- License:
- No exclusive possession is conferred, and licensor may move the tenant elsewhere in the premises, or licensee may share space with another party

7

3. Period/Term of Agreement

Lease: – Generally for a set period of time (e.g. 5 years)

– Some leases may confer rights to the tenant to extend the lease for a further period(s)

– Generally no right to terminate early, unless “with cause”, e.g. if the tenant defaults

License: – Term tends to be for shorter or very specific periods of time, e.g. 6 months or “every Saturday and Sunday between 9:00am and 2:00pm”

– Parties may be able to terminate on short notice, e.g. 1 month’s notice

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8

B. WHAT TYPE OF LEASE ARE YOU SIGNING?

1. Nature of Leased Property

- Residential Lease
 - Lease of a rental unit in a house or residential complex for the purpose of housing
 - In Ontario, governed by the *Residential Tenancies Act*
 - Must be on the government’s standard form lease document as of April 30, 2018
- Commercial Lease
 - Lease between landlord and a “business” tenant, generally for commercial property (e.g. industrial building, unit in an office building, shopping plaza unit)

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- Land Lease/Ground Lease
 - Tenant leases vacant land and moves or constructs building on lands
 - *E.g.* mobile home, Pearson airport, University of Toronto's 245 College Street residence
 - Landlord maintains ownership of land, while tenant maintains ownership of building (at least for the term of the lease)
 - Some leases allow or require tenant to remove building on termination, while others provide that property will become landlord's on termination





2. Rent Structure

- Triple Net or “Net Net Net” Lease
 - Tenant pays all expenses related to the lease, including the “three nets”, *i.e.* property taxes, building insurance and maintenance
 - Landlord maintains structural components of the building, *e.g.* walls and roof
 - If tenant pays this, it is an “absolute net lease”
 - Rent is broken up into two components
 - Basic/Minimum Rent: base dollar per square foot rent solely for the right to occupy the property
 - Additional Rent: everything else incurred by landlord to operate the property

11

- Gross Lease
 - All inclusive – tenant pays one lump sum “gross rent” that includes everything, so there are no hidden fees
 - Gross rent is much higher to ensure that all landlord’s expenses are covered
- Modified Gross Lease
 - Like a gross lease, but terms state that tenant is responsible to pay for certain items separately, e.g. utilities, taxes, insurance
- Percentage Lease
 - Rent based on a stated percentage of tenant’s revenue

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12

C. WHAT IS THE PROPERTY ZONED FOR?

- As a tenant, it is important to investigate municipal zoning before leasing a property
 - Many leases include a clause that indicate that the Landlord makes no representation that the property is zoned for the tenant’s permitted use
- A zoning search will confirm whether a charity or NFP can carry on its permitted use on the leased premises
 - E.g. a place of worship may not be permitted in a shopping plaza
 - Failure to comply with zoning may result in municipal order to cease operations on the leased premises
- Minor variance may be required, but can be costly

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D. HOW MUCH IS THE RENT?

- As qualified donees, registered charities may not confer private benefits to non-qualified donees
- 1. Charity Landlords – Fair Market Value (FMV) Rent**
- Charities that are landlords must therefore charge FMV rent for leases
 - Failure to do so could result in penalties, sanctions, and even loss of charitable status in the event of a CRA audit
 - Exception – leases to other qualified donees (e.g. other registered charities)
- FMV is the value that the property would be rented for at a given time, usually based similar rental properties in the same or a similar area

- FMV can take into consideration many factors
 - Going market rate
 - Services provided by tenant, e.g. lawn maintenance
 - Structures built by tenant and left for landlord on termination, e.g. additions to the property
- It is important for the charity to keep written records of how it arrived at FMV rent in order to justify the amount in the event of a CRA audit



2. Charity Tenants – Leasehold Improvements

- Leasehold improvements are an important factor to consider for charities as tenants
- Leasehold improvements are enhancements to the leased premises made by the tenant not specific to their operations
 - e.g. paint, signage, drywall partitions, counter space, flooring, installing a driveway
- Compare to trade fixtures, which are owned and used by tenant specific to their operations, are physically attached to the property and can be removed without causing material damage
 - e.g. built-in stoves and ovens in a soup kitchen
- Many leases contain a clause stating that leasehold improvements become property of the landlord on termination

- See [CRA Policy Statement CPS-006, “Registered charities making improvements to property leased from others”](#)

- Where leasehold improvements increase property value, any personal benefits to landlord must be offset by reasonable consideration to the charity, for example:



- Ensure that improvements are removed on termination
- Landlord to pay tenant FMV of improvements on termination
- Tenant to be granted discounted rent or a “tenant improvement allowance”

E. A SELECTION OF KEY CLAUSES



1. Right to Extend vs Renew

- Generally extensions and renewals have the same practical effect – the landlord tenant relationship continues for a further specified period
- Extending a lease allows the lease to continue beyond the initial termination date
 - Rights in the lease that are “personal” to the tenant may continue
 - *e.g.* leases frequently state that expansion rights and rights of first refusal are personal to the tenant
- Renewals terminate the original lease and create a new lease, with a temporary “break” between leases
 - Rights “personal” to the tenant are not renewed unless otherwise stated in the lease

2. Assignment and Subletting

- There are much easier ways to get out of a lease...



- Assignments involve a third party assignee taking over remainder of lease and taking the place of previous tenant and their relationship with landlord
 - Leasehold interest is assigned to new tenant
 - Helpful when tenant has no intention to return, e.g. if moving or dissolving
 - Keep an eye out for clauses requiring assignor to remain liable after assignment
- Subletting involves the tenant maintaining the landlord-tenant relationship
 - New renter is the “sub-tenant” (i.e. the tenant’s tenant)
 - Original tenant also becomes new “sub-landlord”

- Tenant is not released from their obligations under the lease, and continues to retain lease with landlord and pay rent to landlord
- Useful when downsizing, e.g. subletting a portion of the leased premises
- Also useful where tenant may want to temporarily vacate premises and resume tenancy later
- Landlord’s consent (sometimes “not to be unreasonably withheld”) is generally required



3. Registering Notices of Lease on Title

- Many leases prohibit registration of leases on title, either entirely or without landlord's prior written consent
- Registration helps tenants by providing notice to future purchasers of property (*i.e.* successor landlords) and lenders of the existence of the lease
 - With some exceptions, registration guarantees “priority” of lease over subsequent instruments
 - *e.g.* If a mortgage is registered *before* a notice of lease, the lender may terminate the leasehold interest. If registered *after*, the lease has priority and the lender must honour the tenant's leasehold interest
- Landlords tend to oppose registration, as notices constitute an encumbrance on title
 - Details of lease may also be made public, which can affect their negotiating power

4. Use Clauses

- Permitted Use clauses set out and limit the business and activities that tenants may carry on in the leased premises, and can be broad or specific
 - *E.g.* “general office use” vs “the operation of a Baptist day camp for children between 3 and 10”
 - Important to discuss and fully understand nature of activities to be carried out by tenant, *e.g.* see *JCP Drugs Ltd. v. Daniels Leslieville Corp.*
- Exclusive Use clauses allow one tenant in the rental complex to carry on a particular use exclusively
 - More applicable in a business context, *e.g.* limiting a shopping plaza to one supermarket
 - Important to ensure that permitted use does not conflict with exclusive uses granted by landlord

F. KEY TAKEAWAYS



Open discussion and communication between landlords and tenants is an essential key to success



Before signing any agreement, all parties should discuss and understand the nature of the rights being granted to ensure the correct form of agreement is used and that the correct terms are included



It is important that tenants conduct due diligence prior to signing in order to ensure that the property can be used as intended



Registered charities and other qualified donees need to be mindful of the rent that they are charging or paying, and ensure that no private benefit is being conferred – this should be well documented

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