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# 22<sup>ND</sup> ANNUAL CHURCH AND CHARITY LAW SEMINAR

Mississauga – November 12, 2015

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## Be Careful What You Sign: Leasing and Related Issues for Churches and Charities

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**OVERVIEW**

- Leasing is usually a major commitment and will generally bind an organization for a long time
- Caution must therefore be taken when signing a lease
- Today's discussion will involve issues from both the Landlord's and Tenant's perspective:
  - Offer to Lease v. The Lease
  - Essential Due Diligence
  - Special Issues for Churches and Charities

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**A. OFFER TO LEASE V. THE LEASE**

- An Offer to Lease or Letter of Intent usually signals the beginning of negotiations
- Caution must be exercised in drafting these documents to avoid unintended consequences
- Letter of Intent: a non-binding document
  - Set out the major financial and business terms
  - Terms will be included in later documents

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**1. What Am I Signing?**

- Term Sheet
  - A bullet-point document outlining material terms and conditions of an agreement
  - Can guide legal counsel in drafting final agreement
- Letter of Intent
  - A non-binding letter setting out major financial and business terms
  - Can guide legal counsel in drafting final agreement



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- Offer to Lease/Agreement to Lease
  - Intended to be a binding document
  - Will contain financial and business terms in more detail than a Letter of Intent
  - May also contain other major lease terms
  - Often will require Tenant to sign Landlord's standard form of lease
- Lease Agreement
  - Intended to be the final, superseding agreement
- Do not become overly concerned with the nomenclature

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- Courts may determine a lease relationship in the absence of an executed lease agreement if 5 essential elements are established
  - a) Premises: must be clearly defined and ascertainable
  - b) Parties: must be correctly named and must be correct
  - c) Rent: all types of rent (minimum, percentage, additional) must be clearly expressed
  - d) Term: the commencement and expiry dates must be clear or readily ascertainable
  - e) All other material terms of the contract not incidental to the landlord and tenant relationship, including any covenants, conditions, exceptions or reservations

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- Even if your non-lease document is not found to create the lease relationship, it can still bind you to obligations that cannot be negotiated in the final Lease
- Highlights importance of engaging legal counsel at an early stage of the negotiations
- Alternatively, ensure that agreements are made conditional on the review and approval of legal counsel



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### 2. What's the Problem?

- Landlords tend to make the signing of their "standard-form lease" a binding requirement in an Offer to Lease
- Usually a brief time period is given to execute
- May or may not include a right to negotiate, which right may be limited to the non-financial terms



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- Significant financial issues may not be addressed in an Offer to Lease
  - What is included or excluded from the definition of "Operating Expenses"; right to audit Operating Expenses
  - What are the Tenant's and Landlord's maintenance, repair and replace obligation? Silence is not golden
  - What are the insurance & indemnity obligations?
  - Is there a relocation obligation?
  - If a multi-unit location, how will shared costs be apportioned?
  - Will the Landlord help with tax exemption applications?

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- Significant non-financial issues may not be addressed in the Offer to Lease
  - Hours of Operation
  - Hours Climate Control will be offered
  - Parking - staff and clients
  - Restrictive Covenants obtained by previous tenants that may conflict with your operations
  - Is there an opportunity to perform sufficient and meaningful due diligence?
  - Termination rights
  - Assignment, subleasing or licensing rights

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### 3. What To Do? Some Options

- Ask for a copy of the standard form lease before signing Offer to Lease
- Ensure there is reasonable amount of time for legal review - ask your lawyer for assistance on the timeline
- Make Offer conditional on final approval of the standard form of Lease
- Include essential amendments to the Lease in the Offer



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### B. ESSENTIAL DUE DILIGENCE

- What is due diligence?
  - The process of verifying all the statements of fact and potential downfalls of the property you are considering leasing
  - It is not a simple matter and can sometimes take several weeks or months to accomplish
  - It may require significant financial expenditures, but it may avoid costly mistakes that may appear in the future



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**1. Samples of Essential Due Diligence**

a) Title Search and Survey

- Should be the first search; if there is something wrong at this stage, there is no point in proceeding
- Confirming ownership of property, which may also require confirmation of corporate status or that the contracting party has authority to act on behalf of the owner
- Confirming boundaries of property, easements, restrictive covenants, etc.
- Determine if any mortgagees from whom a non-disturbance agreement may be obtained

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- Check for agreements, covenants or restrictions registered on title that may conflict with your intended use
- May need to confirm access to the property

b) Zoning

- Can impact on use, signage, parking, developments or alterations to property
- First question should be does the property permit your intended use?
- Examine both permitted uses and the requirements to establish the use
- Any restrictions or limitations?



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c) Commercial Building Inspection/Compliance

- Important even with base building units
- Identify and document physical deficiencies
- Conducting work order search; although tenant will not be responsible, it may be an overall indicator of the condition of the building and the landlord's maintenance standards

d) Environmental

- Extent will depend on the type of lease and property, as well as any environmental covenants contained in Lease
- Phase 1 and/or 2 Environmental Site Assessments
- Identifying environmental hazards and contamination

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- Good to have a baseline for future reference
- Records search of the Ministry of the Environment and the Environmental Site Registry to determine if a Record of Site Condition has been filed

e) The *Ontario Heritage Act*

- May restrict alterations or modifications

f) Technical Standards and Safety Association

- This may include elevating devices, underground storage tanks, boilers and pressure vessels
- Do these devices exist on the property and what is the status of the most recent inspections?

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g) Fire Department and Electrical Safety

- Are there any outstanding work orders?
- Tenant may not become responsible, but it is another overall indicator of the Landlord's maintenance standards



h) Conservation Authority

- Determine if the property is within a Conservation Authority's jurisdiction, are there restrictions on development and any outstanding work orders or breaches of regulations

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- The key to effective due diligence is to review the results and determine if your organization is prepared to accept the associated risk
- Alternatives to due diligence may be necessary if due diligence is prohibitively expensive
  - Representations/Warranties/Indemnities from landlord
    - Can you prove breach or loss? Requisite knowledge?
    - Can Landlord pay?
    - Legal costs and delays may be unsatisfactory
  - Insurance
    - Will your policies cover the loss?

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### C. SPECIAL ISSUES FOR CHURCHES & CHARITIES

- 1) What is the Ability of Charity to be a Landlord?
- 2) Ontario's *Religious Organizations' Lands Act* (ROLA) and Leasing
- 3) Restrictions on Leasehold Improvements
- 4) Concerns with Licences and Common Areas

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- 1) What is the Ability of Charity to be a Landlord?
  - The *Income Tax Act* (ITA) and policies of Canada Revenue Agency (CRA) impose restrictions on the type and extent of activities that can be conducted by registered charities; non-charitable activities are limited
  - Also consider Ontario's *Charities Accounting Act* which says a person who holds an interest in real or personal property for a charitable purpose shall use the property for the charitable purpose.

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- Non-charitable activities must be conducted within the limits of the ITA and CRA policies
  - Non-compliance may expose charity to penalties and sanctions, and may jeopardize the charity's charitable status
- A revenue generating activity is acceptable only if it is a charitable activity, passive investment or related business activity
- A registered charity leasing out premises will only be charitable if it is consistent with their charitable purposes - very nuanced analysis required



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- What does it mean to be consistent with your charitable purpose?
  - Review your objects - what does it permit you to do?
  - Who is your tenant?
  - What is your tenant intending to do on your property?
  - What is your tenant actually doing on your property?
  - Also refer to CRA Checklist for charities on avoiding terrorist abuse

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- Passive investment
  - Charities are permitted to carry on passive investment of surplus assets
  - Need to consider the prudent investment principles; ensuring commercially reasonable terms
- Related Business
  - Two kinds of related business:
    - Businesses run substantially by volunteers
    - Businesses linked to a charity's purpose and subordinate to that purpose
    - See Terrance Carter's presentation for more detail

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- 2) Ontario's *Religious Organizations' Lands Act* (ROLA) and Leasing
  - Unincorporated religious organizations need to remember that ROLA has a general requirement for trustees to obtain authorization by resolution of the organization before exercising any powers conferred by the Act; terms or conditions can be attached to the authorization
  - This should be read in conjunction with the power to permit trustees to lease surplus land "at such rent and upon such terms and conditions as they consider expedient."
  - There is a carve-out for short-term (3-year max) leases, where the organization can give a general authorization

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3) Restrictions on Leasehold Improvements

- CRA Policy Statement CPS-006 "Registered Charities Making Improvements to Property Leased from Others"
- Applies to the standard situation in which a Lease will provide that leasehold improvements made by the tenant will automatically revert to the Landlord at the end of the Lease
- Incorporates the ITA prohibition against registered charities conferring personal benefits or private benefits on its members, shareholders, trustees or settlors



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- When leasing from a non-arm's length Landlord, the Policy requires that where the improvements involve an increase in the value of the property, the registered charity must demonstrate that any personal benefits conferred on the Landlord are offset by reasonable consideration to the charity
- Options to consider include ensuring improvements can be removed by the charity at the end of the lease; the Landlord pays the fair market value of the improvements at the end of the Lease; or the charity pay a discounted rental charge for the cost of the improvements amortized over the term of the Lease

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- When leasing from an arm's-length Landlord (e.g. commercial Landlord), the charity should remember that the ITA prohibits charities from transferring resources to individuals or organizations that are not qualified donees
  - Leasehold improvements undertaken by the charity that increase the value of the property are considered to provide a private benefit to the commercial Landlord
- CRA recommends negotiating for a reimbursement or cost-sharing of the improvements
- Such arrangements should be clearly reflected in the Lease
- Failure to comply could result in deregistration

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4) Concerns with Licences and Common Areas

- These should be concerns of every land owner
- A License is similar to a Lease, except that it does not confer exclusive possession
- Where a tenant has access to Common Areas that are used by the charity, or the charity licenses out its premises on occasion, the charity may be exposing itself to substantial risk of liability for personal injury claims, sexual abuse claims, human rights claims, etc.
- Compliance with charity policies and ensuring appropriate insurance is in place to protect the charity is important
- Adoption of a Facility Use Policy is important

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- A facility use policy articulates the charity's rules and regulations on a number of important issues, including:
  - Prioritization of use of facility
  - Restrictions on the use of the facility
  - Insurance and indemnity requirements
  - Application process
  - Setting out a Facility Use Agreement
- In adopting a Facility Use Policy, the charity must consider issues of the charity's purposes, its reputation and its exposure to liability
- Important to advise charity's insurer of third-party use

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- Charities should adopt a standard facility use agreement to outline the terms of third-party rentals
- In addition to basic business terms, should include:
  - Insurance requirements
  - Indemnities
  - Restrictions on use
- Cannot contract out of obligations under *Occupiers' Liability Act* (Ontario)
- Needs to conform to human rights legislation

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## D. THE FINAL DETAILS

- As leasing will involve lengthy and costly obligations to the charity, the final details are just as important as the initial due diligence and Lease negotiations
- Ensure corporate authority is obtained
  - Help future boards by documenting what was authorized
- Carefully review the final Lease document
- Properly execute and retain a copy in a Leasing file

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