UPDATED – 2019 EXAMS

$27.99

MiniCram

REAL ESTATE EXAM

NOTES QUESTIONS

COMMERCIAL

REAL ESTATE TRANSACTION

- ✓ SUMMARY NOTES
- ✓ 200 QUESTIONS
- ✓ CASE STUDIES
- ✓ DETAILED ANSWERS

www.MiniCram.com

MiniCram Real Estate Exam

The Commercial Real Estate Transaction

Study Notes & Practice Questions

UPDATED – 2019 Exams

All rights reserved. No part of this publication may be reproduced, transmitted or stored in any material form (including photocopying or storing it in any medium by electronic means and, whether or not transiently or incidentally, to some other use of this publication) without the prior written consent of the publisher. No patent liability is assumed with respect to the use of information contained in this publication.

Warning and Disclaimer

The information contained in this publication is essentially a summary, for the only purpose of review of key concepts for exam preparation and is not intended to replace direct research or original source documents, actual classroom training or expert advice. This publication is for the sole purpose of education.

Every effort has been made to make this book as complete, error free and as accurate as possible, but no warranty or fitness is implied. The information is provided on *'as is'* basis. The author and the publisher shall have neither liability nor responsibility to any person or entity with respect to damages arising from the information contained in this publication.

This warning and disclaimer applies regardless of whether you access this publication in paper format or using any electronic means. In case you are accessing this publication in any electronic format, including through the Internet, you expressly agree that the author or the publishers are not responsible or liable for any loss or corruption of data, and damage to hardware, software, applications and the operating system.

► ***There is no representation, warranty or guarantee, of any kind whatsoever, whether expressed or implied, that the student will pass the exam. We provide only sample practice questions to help you in exam preparation. These practice questions should not be considered actual exam questions. No return, exchange or refund will be issued once the book has been purchased. You are encouraged to review the Samples before placing your order.***

The author and publishers are not affiliated with, endorsed by or have any sponsorship from the Real Estate Council of Ontario (RECO), the Ontario Real Estate Association® or any Real Estate Board.

Acknowledgements

The terms MLS® and REALTOR® are registered trademarks of the *Canadian Real Estate Association® (CREA®).* OREA® is a trademark of the *Ontario Real Estate Association®*. RECO® is a trademark of *Real Estate Council of Ontario*. The use of these trademarks or logos in this publication is intended only for the purpose of general information and education and is not to affect any validity or legal status associated with them.

MiniCram

TABLE OF CONTENTS

MiniCram

INTRODUCTION

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.

This booklet has been written so that you can focus on key areas of study as well as practice sample questions to overcome the most common mistakes that students make on the actual exam.

How to Use This *MiniCram*

You do not have any time to waste. This ***MiniCram*** booklet is designed in such a way that your review for the exam is fast paced. It is suggested that you go through each topic one by one. It is assumed that you have already covered the topics either in the actual class or by self-study.

We Want to Hear from You

This book is written by a practicing professional. If you have feedback for the author, want to submit a question, report any mistake in the book, need more information or have general comments, please send an email to info@MiniCram.com.

We hope that this book will prove to be helpful for your exam preparation. Good luck for the exam!

EXAM FORMAT - THE COMMERCIAL REAL ESTATE TRANSACTION

This 3-hour exam consists of a total of 50 Multiple Choice questions. Minimum 75% marks are required to pass the exam. For your reference, blank or completed agreements would be provided in the exam. The breakup of marks is as follows:

First 12 Questions	**1 Mark Each**	**12 Marks**
Next 26 Questions	**2 Marks Each**	**52 Marks**
Last 12 Questions	**3 Marks Each**	**36 Marks**
Total Questions – 50		**100 Marks**

In case of paper exam, the exam booklet is separate from the answer sheet, which is a machine-readable *Scantron®* sheet. The answer sheet is to be filled up with pencil only. On an iPad exam, you may navigate the pages using the '*Next'* and '*Previous'* buttons.

For more information on the exam, visit the official website at www.orea.com.

Back to Table of Contents

10 TIPS FOR THE EXAM

1. ***RELAX!*** Too much anxiety, panic, stress and fear are big distractions. Focus on the question and choose the best answer.
2. ***GAME OF WORDS.*** All multiple-choice exams are merely variation of words. If you know your course materials, it's only a matter of interpreting the question and then selecting a correct option.
3. ***EASY ONES FIRST.*** In this exam the first 10 questions are easy, simple and straightforward questions. Do these questions first. If math is your weakness start with these easy the questions.
4. ***READ ALL OPTIONS***. Even if you think A is the correct answer, read options B, C and D to make sure they are incorrect.
5. ***MANAGE YOUR TIME WISELY***. Divide it according to marks for each question. Do not spend too much time on 1-mark questions. Skip the question that you think is difficult to answer. Mark it for review and proceed to the next one.
6. ***EXTREME PHRASES***. Beware of absolute words in any option such as *ALL, ALWAYS, NEVER, MUST, NONE, EVERY, EXACTLY, ONLY*, etc. In most cases, the options that include any of these words are rarely correct.
7. ***HEDGE PHRASES***. When a question asks you to conclude something and includes words such as *MAYBE, LIKELY, OFTEN, ALMOST, USUALLY, GENERALLY, TYPICALLY, SOMETIMES*, etc. Do not pick any answer that does not leave any room for exception.
8. ***ALWAYS*** read the question twice. You must know what information is given and exactly what is being asked. More than one choice may seem to be correct if you do not understand the question properly. If that is the case use the method of elimination.
9. ***REMEMBER*** that your first instinct is mostly a correct answer. Be careful when changing your answer but don't be afraid if you must change it.
10. ***REVIEW.*** Make sure you did not skip any question and the answer sheet is neatly filled in. Never mark more than one answer. If you need to change a marked answer erase the previous one nicely. Otherwise, the machine may not be able to scan your answer.

Back to Table of Contents

MiniCram

PART I – STUDY NOTES

1. THE OFFICE AND RETAIL MARKET

1.1 The Office Market

Market Indicators

- *Available Office Space*: Total square footage available for lease.
- *Inflow of New Office Space*: Total square footage recently made available.
- *Absorption Rate*: The monthly or annual rate at which office space is leased or occupied.
- *Net Absorption Rate:* The *Net* figure is more reliable and shows the total office space leased *less* space vacated during the period.
- *Vacancy Rate*: The percentage of unleased or unoccupied office space vs. the available space.
- *Rent Rate*: Rent per square foot. *Net Rent Rate* is preferred as taxes, maintenance and other operating expenses are considered.
- *Natural Vacancy Rates:* This refers to normal *Vacancy Factor* when rents are at *Equilibrium*, negotiations do not affect rental rates. Rents are low above Equilibrium and high below Equilibrium.

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 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, they 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.

Office Condominiums

- Condominium units are taken by smaller tenants who seek independence from occupancy costs and landlord controls.
- The office unit size varies between 750 and 1500 square feet and includes on-site parking.
- These offices may have shared utilities such as boardroom, reception, video surveillance, entry systems and telephone systems.

1.2 Zoning By-Laws

Tax Perspective

- Office buildings generate employment and tax revenues for the municipality.
- They create a buffer between industrial, retail commercial and residential areas.
- From planning perspective, the main considerations are conformity with existing structures, parking space, municipal services, transportation and accessibility.

MiniCram

Restrictions

- Restrictions are imposed through *Zoning By-laws* and *Land Use Control*.
- They affect the *Gross Floor Area*, maximum building height, permitted use, setbacks and maximum lot coverage.
- Restrictions are typically found in agreements between the developer and the municipality.
- *Floor Area Ratio (FAR):* This ratio is expressed as total floor area of building in relation to total land area.
- Both *Floor Area Ratio* and height restrictions impact the *Gross Leasable Area* which, in turn, affects the cash flows and returns.

1.3 Office Building Construction

Design and Layout

- Structural design and layout is regulated by *Ontario Building Code (OBC).*
- Regulations are focused on structural strength, integrity, acoustic separation, means of exit, sanitary conditions, prevention of heat loss (insulation), water intrusion (damp-proofing) and moisture (vapour barriers).
- *Ontario Building Code Part 9: Housing and Small Building code* applies to buildings between 10 square metres (108 square feet) and 600 square meters (6,460 square feet) and up to 3 storeys in height.

Smaller Buildings

- Small commercial buildings may use economical wooden framing while meeting standards for loads and fire separation between units.
- Drywall materials provide the necessary fire safety ratings.
- Masonry concrete walls may be used along with wood framing in large commercial to more effectively separate units.
- Common areas such as stairs may also be of concrete blocks or poured concrete.

Larger Buildings

- The structure of typical large office buildings is made of steel, concrete or a combination.
- Steel structures are flexible and effective in handling wind load and seismic activity.
- High-rise steel structures are supported by strong heavy weight steel framing made of columns and *I-beams*, upon which floor and wall materials are installed.
- Light-weight steel is used for internal framing and for smaller buildings.
- Concrete is preferred because steel becomes soft at high temperatures and needs some passive, fire resistance material for encasing.
- Reinforced concrete buildings are broadly categorized into *cast-in-place (poured in place),* which is cost-effective or *precast* and delivered to the job site for installation.
- Concrete *cast-in-place* (concrete framed) buildings can withstand high temperatures for long periods and have strong resistance to explosions.

Building Core

- The central component of the building which has provisions such as toilets, elevators, janitor’s room, closets, utilities, mechanical facilities and stairs.

MiniCram

- *Center-Core* designs for multiple tenant building and attracts companies who prefer outside windows for management executives while internal areas is used by staff.
- *Side-Core* designs are off-centre and suited for single tenant where most staff has similar functions.

Floors

- *Floor Plate* design depends on needs of the tenant, leasing depth, particularly the distance from either the center core or corridor.
- Zoning setbacks *and* Ontario Building Code requirements also affect floor plate design.
- *Floor Height* directly impacts costs which increase when floor-to-floor height increases.
- *Floor-to-Ceiling Height* is the distance from top of one floor to the top of the next floor.
- *Sandwich space* is the space between the finished floor and the dropped ceiling.

Exterior Curtain Walls

- They span multiple floors, while allowing for building movement and expansion, effectively sealing exterior and providing thermal efficiency for heating and cooling.
- These continuous systems typically consist of glass inserted in aluminum or stainless-steel framing.
- High-performance glass with special coatings minimize *glare* and reflect long-wave radiation.
- *Low-E* glass contains a thin metallic layer to allow filtered sunlight inside the building during winter while retarding outward flow of heat.
- *Double-glazed* and *Triple-glazed* windows may have inert gas fill (*Argon* or *Krypton*) between panes to reduce heat or cold transfer.

Life Safety Systems

- These systems are regulated under *Ontario Fire Code* for safety of occupants during emergency situations. The size of the building and its use determines requirements.
- Typical systems include use of fire detection and alarm, emergency communication systems, strategically placed firewalls, automatic door closures, emergency lighting, ventilation, auxiliary power and sprinkler systems.

1.4 The Retail Market

Structure of Retail Market

- *Large Merchandisers*: They negotiate better prices from suppliers with big orders and this results in cost savings to consumers. They use hi-tech distribution centers, retail tracking systems, self-check-out systems and improved customer service.
- *Supply Chain*: Include *Bar Code* systems and *Radio Frequency Identification (RFID)* for efficiency, consumer access to product info and interactive shopping.
- *Online Retailing*: This has impacted retail business with retailers and online distributors in direct competition, but the consumer has to negotiate.

Retail Classifications

- Retail standards are governed by *North American Industry Classification System (NAICS)* and the classifications are based on type of product.

MiniCram

- *Big Box Stores*: These stores look like warehouses with minimum interior finishes. They buy inexpensive large industrial lands and get it rezoned for development of a store that sells everything.
- *Power Centres*: Several big box stores are located at one place. *Category Dominants or Category Killers* are those stores which sell a specific product.

Shopping Centres

- *Regional Shopping Centre*: These are typically enclosed and there are two or more anchor tenants (crowd pullers).

- *Community Shopping Centre*: These are usually L-shaped or U-shaped, located near main arterial roads or at town centers and have one or two anchor tenants to attract customers.

- *Neighbourhood Shopping Centre*: These are small retail centres which generally have convenience stores, grocery store, laundry, pizza, small restaurant, dollar store, etc.

Miscellaneous Retail

- *Lifestyle Centres*: These are smaller than Regional Shopping Centers but provide an open-air, village like shopping for upscale consumer with reduced maintenance expenses.

- *Downtown Shopping Malls:* Malls such as *Eaton Centre* revitalize downtown shopping within large metro center.

- *Outlet Malls*: These malls have brand-name retailers and factory outlets and typically attached to some warehouse to sell returned or surplus goods at a low price.

- *Main Street Retail*: They have a blend of old and new by creating a tenant mix of boutiques, convenience stores, travel agents, coffee shops, offices, fruits and vegetables, and other businesses.

- *Freestanding (Single-Use) Buildings:* Gas stations, banks, restaurants, etc. prefer single use buildings for greater vehicular exposure, visual separation and a separate identity.

Mixed-Use Developments

- *Single Master Plan:* Mixed-use developments involve three or more standalone, profit making uses such as retail, office, residential, entertainment, etc.

- *Complex Design*: Proper planning and integration of diverse uses is critical for mixed use developments and may include even big box stores.

- *Vertical Mixed-Use Buildings*: Town Centre mixed use designs include parks, pedestrian walkways, benches, fountains and public squares integrated into an urban landscape.

Ground Lease

- This refers to a long-term lease of land to a tenant for building a retail structure.
- The building itself serves as a security for rent payments.

MiniCram

- By this method the tenant can leverage existing finances and use the property as if it is owned.
- Disadvantage is that the landlord may not permit expansion.

1.5 Retail Planning and Zoning

Planning Considerations

- *Market Position*: This refers to the fact that consumers are attracted by a limited number of businesses. This is why smaller retailers want a location close to larger shopping complexes to attract customers.
- Range: Range refers to maximum distance that a typical consumer will travel to buy a specific commodity.
- *Competition:* A shopper will go to closest location if competitors are offering the same product at a similar price.
- *Clustering*: Mix of tenants in a retail centre is preferred by consumers because several items are available at a single destination.
- *Threshold*: Businesses evaluate minimum population densities (threshold) required to support a specific retail business.

Zoning Requirements

- Municipalities must create and update *Official Plans* and draft zoning provisions that encourage a competitive, healthy retail sector and preserve existing commercial resources and at the same time, not inhibit new retailing formats or dampen competition for consumer choice.
- Zoning categories use sequential numbers (C1, C2, C3, etc.) or they may be location specific.
- Buildings activities must meet setback requirements, parking width and depth and, minimum separation from residential zones.
- Off-street parking allowed is typically based on retail use and gross floor area.
- *Gross Floor Area* is the total area of each above grade floor in the building.
- *Site Plan Control* ensures that retail buildings adhere to *The Planning Act*, *Official Plans* and *Zoning By-laws*.
- *Site Plan Control Areas* are designated by local municipality.

1.6 Retail Construction

Masonry and Concrete

- Smaller retail buildings have load-bearing masonry walls with light weight internal steel framing.
- Masonry wall height is determined by concrete block size which may or may not be reinforced.
- Masonry walls increase the *thermal mass* of the structure and are energy efficient.

- *Concrete Tilt-up Wall (Tilt Wall):* These walls use large wall panels that are poured on-site and raised into position by cranes.

- *Pre-cast Wall*: These walls are made off-site and transported to site.

MiniCram

- *Internal Concrete Form (ICF):* These structures are built using polystyrene forms that are assembled according to the shape of exterior walls.

Steel Buildings

- Small buildings use lightweight steel which can be assembled quickly on site.
- Steel is more cost effective but can bend easily and lose its strength when exposed to extreme heat and high temperatures.
- Because of this reason, steel buildings require additional fire-retardant materials such as gypsum board, wraps or blankets.
- *Modular Standalone Structures*: These are easy to install, pre-built steel modules which include all framing and a pre-poured floor.
- The benefits include quick assembly, theft protection, few sub-contractors, flexibility to easily relocate or expand structure, etc.

Parking Garages

- Parking requirements depend on available land size and cost.
- Standalone buildings have on surface parking while structured parking is necessary in larger complexes.
- Parking garages are typically built using beams and columns, along with pre-cast, pre-stressed slabs which form the parking deck.
- Some garages are constructed with pairs of interwoven, one-way spiral ramps.

Back to Table of Contents

MiniCram

2. INDUSTRIAL LAND AND BUILDINGS

2.1 The Industrial Market

- The industrial market includes vacant land and buildings used for manufacturing (production), storage (warehousing) and distribution of commercial goods and services.
- *Investor vs. User*: *Investors* need large and long-term credit-worthy tenants while *Users* are inclined more towards location, access and visibility to the property.
- *Derived Demand*: Demand is based on specific functions. Distributors focus on transportation corridors, time/distance factors and freight rates. Manufacturers concentrate on distance to raw materials, availability of energy for manufacturing and availability/cost of labour. Market based industries look for closer customer base.
- *Existing Structures*: Existing buildings are often converted into smaller affordable rental units for newer industrial tenants who will ultimately grow and move out.

Industrial Building Categories

- *General Purpose*: These buildings have facilities for different types of uses and are most common.
- *Special Purpose*: These buildings appeal to selected industries such as buildings with loading docks. These buildings have narrower applicability than General Purpose.
- *Single Purpose*: These buildings have little appeal, are expensive to convert and are difficult to market. Oil refineries or heavy industrial uses are in this category. Appraisal is challenging.

Valuation of Industrial Property

- Appraisers provide cost estimates using *Per Square Foot* or *Per Buildable Square Foot* method using land cost and building cost (hard costs and soft costs).
- *Hard Costs*: These costs include cost of site preparation (excavation, fill, landscaping, asphalt, curbs, etc.), structural, mechanical and electrical components.
- *Soft Costs:* These are costs incurred in consultation, project management, financing, legal and connection charges.
- *Land Costs*: The cost of land is typically quoted per square foot using the total square footage of the site. Some brokerages prepare reports based on *per buildable square foot*.
- *Investor Return*: Return is the relationship between rental income per square foot and total cost per square foot.

Design Build

- *Design Build* is an agreement between a land owner and a tenant to build a structure according to the requirements of that tenant.
- This is popular in seller's market when the demand for industrial land is high and availability is low.
- These options require a detailed analysis of tenant requirements, building size and costing estimates along with lease vs. own options.
- Involvement of commercial brokerage includes activities related to detailed costing estimates for land and building as well as financing costs, real estate commissions, closing expenses, cash flow projections, present value estimates and internal rates of return.

MiniCram

Sale/Leaseback

- Sale/leaseback arrangement involves the sale of property by an owner to an investor and leasing it back from the buyer.
- The seller liquidates his equity in the property for use with other projects while retaining the location under a long-term lease.
- The buyer as investor is assured of a long-term lease and cash flows.
- The seller may have the option to buy it again after lease is over.

2.2 Requirements for Industrial Sites

Community Profile

- Industrial users consider site requirements (zoning restrictions, services, transportation, etc.) from community, regional and provincial perspective.
- Labour intensive industrial uses require information on wage levels, availability of skilled labour, facilities and public transportation to the site.
- Sources of information include local development offices, demographics, labour statistics, private employers, transportation, quality of life issues, financial services and real estate profiles.
- Industry Canada's *'Strategis'* website provides both business and consumer resources.

Availability Factors

- *Land Acquisition and Retention:* Mainly driven by economic development commissions while municipalities also purchase land to exercise control on types of industry.
- *Zoning Requirements*: Define the scope and mix of industrial activities, encourage competitive uses, set height and size limitations, and density requirements.
- *Site Availability and Expansions*: Related to servicing extensions (water, sewer and transportation) for raw industrial lands with the help of improvement funding by local government.

2.3 Industrial Zoning

Zoning Provisions

- Zoning By-laws and permitted uses vary by municipality and are grouped in terms of general and heavy industrial uses.
- Zoning classification sets out requirements for specific uses, lot frontages, lot areas and minimum front, side and rear yards.
- Permitted industrial uses typically include manufacturing, warehousing, research and training facilities, transportation terminals, public works depots, contractor yards, service and repair operations, electric power facilities and auto service establishments.
- Industrial activities also include manufacturing, fabrication, assembly, processing and packaging of products.
- *Heavy Industrial Use* involves refineries, brick, tile or clay production, blending tar or petroleum for roofing, paving activities, tanneries, rendering chemicals, heavy equipment manufacturing, meat packing and bulk storage of chemicals, fuels, etc.
- *Industrial Park*: It is a controlled development designed as a buffer between heavy industries and residential areas.

MiniCram

Single-Use vs. Multi-Use

- *Single Use* industrial buildings are usually standalone structures. Modern industrial areas are dominated by large multi-use buildings to attract leasehold tenants.
- An *Industrial Mall* is often set up as a condominium with individual units, common parking and loading facilities.
- In *Vacant Land Industrial Mall Condominium,* the developers divide and sell lots without the need to create a subdivision.

2.4 Typical Building Components

Construction

- Free standing buildings typically include both a main industrial area and an office area.
- Industrial structures are usually made with concrete blocks, poured concrete, steel or their combinations.
- Steel structures are now preferred for single-storey small and medium sized industrial buildings. Pre-engineered steel structures are manufactured at a factory and are cost efficient.

Features and Characteristics

- *Bay*: The smallest division of unfinished floor area between columns and bearing walls.
- *Bay Depth:* The distance from the bearing wall to a row of columns or between columns.
- *Span:* Floor area that is clear of interference of columns and walls.
- *Clear Height:* The unobstructed distance from floor to the ceiling.
- *Cranes*: *Bridge Crane* operates on a system of horizontal rails and needs column free areas. *Gantry Crane* is a portable bridge crane operating on wheels and can be moved on floor or outside. *JIB crane* has an arm attached at an angle to a mast and can rotate 360 degrees.
- *Roofing*: *Flat Roofs* have some slope for water drainage and must be water tight. A *Built-up Roof (BUR)* consists of asphalt, felts and gravel.

- *Floor Load*: Consists of two types –

    - *Live Load* consists of weight of people, equipment and materials.
    - *Dead Load* refers to the weight of structural materials.

- *HVAC*: Heating, Ventilation and Air-conditioning (HVAC) systems consist of Air Handler, Condensing Unit, Duct work, Roof Top HVAC, Unit Heater, etc.

- *Loading Dock*: These are at truck level height and typically found in commercial and industrial structures.

Sprinkler Systems

- The term *Sprinklered* refers to a building that has a built-in sprinkler system.
- Sprinklers are interconnected pipes, risers, mains and sprinkler heads and uses water.
- Automatic systems are controlled by smoke alarms or heat sensitive detectors.

- *Wet Pipe:* Fitted with water under pressure and released when a plug melts at high temperature.

MiniCram

- *Dry Pipe:* It has compressed air extending from sprinkler head to a dry pipe valve. It releases water when the plug melts and air pressure drops.

- *Pre-Action:* This system contains air under pressure and water is released when heat activated device is operated by a valve.

- *Deluge*: This system uses large quantities of water for unusual fire hazards.

Transformers

- *Pole Transformer*: Located on a pole near the street and is used for small service sizes under 600 Amp.
- *Mat Transformer:* Within a large cabinet located on ground next to the building.
- *Pad Transformer:* Combination of several mat transformers installed on a pad.

Back to Table of Contents

MiniCram

3. MULTI-RESIDENTIAL, FARMLAND AND RECREATIONAL

3.1 Multi-Residential Buildings

Demand and Supply

- *Multi-residential*: Any residential structure that has more than one dwelling unit.
- Smaller residential buildings such as duplexes, triplexes, fourplexes, etc. are excluded.
- From regional perspective, expanding employment opportunities normally translate into increased housing demand.
- Rising income levels dictate potential price points for various types such as studio, one, two and three-bedroom apartments.
- *Demographics* such as *in-migration* and *out-migration,* overall population growth also help in analysis.
- Proximity to schools, transportation and nearby retail services, as well as amenities in the building also attracts people.
- Analysis of existing competition, as well as new buildings currently approved or under construction.
- Rent levels and what is and what is not included in the rent, condition of property, basic features (above and underground parking, balconies, park areas and access control systems), elevator, exercise room, swimming pool, entertainment rooms and location features are also considered during analysis.

Impact of the Residential Tenancies Act

- The *Residential Tenancies Act (RTA)* provides protection to tenants.
- Decision for acquisition or development must consider annual *Rent Guideline* published by provincial *Ministry of Municipal Affairs and Housing*.
- Other provisions include *Vacancy De-control*, procedures for recouping capital expenditures, rights of entry by landlord, notice periods for termination of tenancy, etc.
- These provisions impact cash flows, rates of return, upgrading existing structures and ongoing investment/management decision making.

Zoning

- Residential zones are identified as R1, R2, R3, etc. with multi-residential zones in range R6 or higher.
- All multi-residential buildings must comply with Ontario Building Code and construction methods depend on the size which may be low-rise, mid-rise or high-rise.
- The zoning provisions include minimum lot area, frontage and floor area; maximum lot coverage and height; minimum front, side and rear yard setbacks; units per hectare, parking allocation per unit; and landscaping minimum given in percentage of total lot size.

- Infill Zoning Requirements –

    - *Infill zones* are typically found in inner city neighbourhoods.
    - *The purpose is to lessen urban sprawl within existing urban areas, increase in density and better utilization of existing municipal infrastructure.*
    - Municipal planning officials compare a proposed project in comparison to surrounding built-up areas.

MiniCram

- Planners prefer multi-residential projects that have a low profile with density, height, setback and built form that is sensitive to surrounding built-up areas.

Multi-Residential Agreement

- A large multi-residential building is considered a *Business* under the *Real Estate and Business Brokers Act 2002*.
- *Sale of Business Affidavit*: This statement under oath must be provided to buyer in case seller does not provide financial statements.
- The *Agreement of Purchase and Sale - Commercial* typically includes information on tenancies and copies of all leases or a condition is included to deliver these documents a specified time period.
- *Confidentiality Clause:* This clause is typically included the agreement as buyer needs to review a number of business documents.
- *Notice to Tenants:* Notices for rent increases must be as per *Rent Guidelines* and such notices may fall within the period between offer acceptance and closing.
- Tenants must be informed by the seller about change in ownership and to pay all future rents to buyer.

3.2 Agricultural and Farm Land

- The term *agriculture* refers to the production of goods through farming.
- A *farmer* is described as an individual, corporation, co-operative, partnership or other association that is engaged in farming for commercial purposes.
- *Farming* is defined in the federal statute, *Farm Debt Mediation Act* 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.

Evaluation of Farm Market

- Location factors include proximity to target market, accessibility by roads and availability of services.
- *Land Value* is usually based on agricultural productivity and soil fertility.
- *Crop Heat Units (CHU)* is important for crop selection and in estimating productivity.
- Time period for crop maturity generally depends on temperature, soil fertility and moisture levels in soil. The type, age and condition of structures and equipment also affect value.
- *Farm Quotas* and government programs and incentives can impact value.

Farm Quotas and Marketing Board

- *Farm Quotas* affect the value of farm property and a dairy farm may have little value in spite of large production if farm quota is not assigned.
- *Marketing Boards* are governed by farmers.
- *Negotiating Boards* negotiate the minimum price paid to producers.
- *Boards with Authority to Establish Price* set the price paid to producers but cannot limit production.

MiniCram

- *Boards Regulating Production and/or Marketing Using Quotas* can establish exact quotas for each farmer.

Farm Land Leasing

- Under lease terms, the landlord provides the farm land and storage facilities, and pays for property taxes.
- The tenant pays the expenses for supplies, labour and machinery for farming.
- *Crop Share lease*: Most common division of income is *one-third share* of all crop sales goes to the landlord.
- *Cash Rent Lease*: The tenant pays a fixed amount to landlord but receives all income from the crop sales.
- *Flexible Cash Lease*: The tenant receives all income from crop sales, but the amount paid to landlord varies with either the price of the grain, the yield of the grain, or both.

Farm Land Zoning

- Zoning provisions prevent the farm land from being converted to non-farming uses.
- *Agricultural Use* refers to the use of land involving the tillage of soil, growing and harvesting of vegetables, field crops, tender fruits and other cash crops.
- Dairy operations, breeding, grazing, boarding and training of livestock activities are also termed as agricultural operations.
- It includes buildings involving manufacturing, processing and servicing establishments that support agricultural uses.

Farming and Food Production Protection Act (FFPPA)

- The law provides farmers protection from nuisance complaints and lawsuits on injunctions.
- It also ensures that farming and food production industry is protected from restrictive municipal by-laws that constrain normal farm practices.
- *Normal Farm Practices Protection Board* is established under this law to decide on complaints.

Construction

- *Ontario Building Code* and *National Farm Building Code of Canada* specify requirements for construction of farm buildings for farm equipment, production, storage and processing of agricultural products and for housing livestock.
- A site investigation may be necessary to assess soil conditions.
- Zoning by-laws will set out minimum building setback requirements.
- *Minimum Distance Separation (MDS): MDS-I* is the minimum distance between new development and existing livestock or storage facilities. *MDS-II is* the distance between livestock or storage facilities and houses.

Nutrient Management Act

- This act regulates storage, handling, use and transportation of commercial fertilizers.
- Commercial farming industries are required to document and retain records relating to *Nutrient Management Plans (NMP)* and *Nutrient Management Strategies (NMS).*
- The act also specifies minimum distance requirements regarding land applications (i.e. fertilizers) to protect adjacent land and water sources.

MiniCram

Miscellaneous Issues

- *Tile Drainage*: It removes excess water from crop roots and increases crop output. Farmers may be eligible for *Tile Loan Programs* under the *Tile Drainage Act,* approved by local municipality.
- *Dams, Drains and Diversions*: These activities fall under the *Lakes and Rivers Improvement Act* enforced by *Ministry of Natural Resources (MNR) and* a *Work Permit* may be required.
- *Soil Testing*: Used to determine the type and amount fertilizers for the soil for best crop production. *Ministry of Agriculture, Food and Rural Affairs* has an accreditation program. The success of test depends on number of samples, which are usually taken every two or three years.

Sale of Farm Land- Buyer Considerations

- *Resident Status*: Is the buyer a non- Canadian citizen or a non-resident and will the buyer be able to generate certain level of income?
- If the buyer and the property qualify, has the buyer registered under the Act?
- *Registration Deadlines*: If the sale closes after September 1st, the buyer may lose the benefits of the reduced rate. If the sale closes before September 1st, the buyer can register prior to the deadline.
- *Property Taxes:* Ontario farmers receive 75% tax reduction for municipal taxes if the property is assessed as farmland and if they-

    - Continue the farming business,
    - Are Canadian citizens or permanent residents,
    - Have *Farm Registration Number*, and
    - Annually submit the appropriate application.

- *Income Tax:* Farm land is treated similar to improved real property. *Capital Gain* is subject to tax on seller's income (50%). Previously claimed *Capital Cost Allowance* may also be *Recaptured*.
- *HST:* Personal use farm land may be exempt from HST if it is sold to a related individual who will continue the use.

3.3 Recreational Properties

Types of Recreational Properties

- *Small Recreational Business*: These properties on lakeshores mainly offer boating facilities.
- *Wilderness Camps*: These are camps for fishing and hunting with required fishing licenses.
- *Bed and Breakfast (B & B):* These operations are regulated by local Bread and Breakfast Association and are typically located in private residences.
- *Ski Chalets/Small Lodges*: These businesses offer facilities for skiing, snowboarding, snowshoeing, skating and sleeping accommodation.

Hotels, Motels, Lodges and Resorts

- *Market Analysis*: The demand is determined by occupancy levels for a particular locality or region based on travelling preferences of consumers.
- *Hotels/Motels*: Motel is a building in which accommodation and meals are provided. Large hotels rely on analysis and market studies; smaller hotels focus on individual fact finding.

- *Boutique Hotels*: This is a luxury and expensive accommodation market catering to lifestyle preferences such as wellness and SPA facilities.
- *Lodges:* A lodge primarily consists of an inn with cabins or cottages offering four or five-star accommodation including golf courses, on-site SPA, pools and fitness centres. Lodges are associated with accommodation, while resorts provide recreation as well
- *Resorts*: Resorts usually offer four or five-star accommodation and may have golf courses, on-site spa, fitness centre, indoor/outdoor pools, etc. A resort may be a *Resort on a Lake* or *Resort Town* or *Resort Area*.

Planning and Zoning

- Municipal B & B licensing requirements are generally very stringent and renewable annually.
- They must also be in compliance with zoning by-laws, the *Ontario Fire Code* and selected health regulations.
- Waterfront areas must comply with lot sizes and frontage requirements.
- Environmental matters are also significant issues.
- Older lodges are being updated and expanded to include housing options, recreational and community-based facilities and limited commercial/retail services.
- Municipalities generally try to maintain the historic character of older resorts.
- Amendment to the Official Plans may be required.

3.4 Land Development

Development Land

- Vacant industrial land commercial market is primarily focused on development activities.
- *Land* technically refers to raw acreage or unimproved land, no alternation and services may also not be available.
- *Site* refers to a parcel of land that is often serviced to some extent, may have been subdivided and a building can be built with minimum time frame.

Planning Act Considerations

- Local municipalities use their *Official Plans* to enforce the *Planning Act* requirements for development of industrial land.
- *Zoning By-laws* define industrial zones and set aside land for specific purposes and uses.
- Municipalities must ensure that *Provincial Interests* given in the *Provincial Policy Statements* are consistent with *Zoning By-laws*.
- Public meetings are also required to get public opinion in regard to new developments.
- In case of a dispute between a developer and a municipality, the *Ontario Municipal Board* hears applications and appeals for proposed development projects.

Land Development Application

- The application process begins with consultations between developers and municipal planning departments before submitting the application.
- Typical process involves amendments to *Zoning By-law* or the *Official Plan*, *Draft Plan* approvals (subdivision or condominium) and/or *Site Plan* applications.
- The application must include drawings (survey & site development plan).
- A *Joint Development Agreement* and *Site Plan Control Agreement* are negotiated for *Work Permits*.

MiniCram

Required Studies

- *Water* - A *Hydrogeological Report* may be required to confirm water capacity in the serviced area.
- *Sewage* - Confirmation of sewage capacity along with a Hydrogeological Report would be required to assess effects of water contamination.
- *Storm Water* - A preliminary and formal storm water management plan is normally required.
- *Environment* - Assessment provides impact of proposed activities on environment and existing sites may require remedy of some environment hazard.
- *Municipal Engineering* - This involves study and technical analysis of existing municipal infrastructure and impact of the project on existing services.
- *Acoustics* - This involves a study of noise effects from the proposed project.
- *Urban Design* - Expertise is required to develop an effective streetscape.

Development Agreement

- A *Land Development Agreement* is required as a condition for approval of *Amendment Application* (Zoning By-law or Official Plan).
- The agreement sets out development requirements, development charges and bank guarantees to ensure proper provision of services.
- Local improvement and development charges may also be payable.

Back to Table of Contents

MiniCram

4. INVESTMENT PROPERTIES

4.1 Investment in Commercial Property

Advantages

- The investor gets an opportunity to grow capital.
- Additional equity can be built up by reducing the mortgage debt over a period of time.
- The rate of return is higher as compared to other investments.
- Investment properties offer higher than usual personal control on investment.
- Tax sheltering helps in reducing tax liability.
- The investment has physical presence in the form of land and building as opposed to just commercial documents as in case of stocks.
- Use of *Leverage* can help limit the investment required
- The property can be refinanced after certain period to recover initial investment.
- The property can be divided to create additional estates.

Disadvantages

- A large capital investment is required as opposed to residential properties.
- Lack of *Liquidity* is a major problem as it takes time to sell the property and recover investment.
- The expenses incurred in administration and management of property may be high.
- Realty commissions and legal expenses during sale may be significant.

4.2 Decision Making

User

- A *User* is primarily interested in good location, easy access and visibility.
- Buyer's interests in use of property are important.
- Improvements in the property must be able to accommodate the staff and equipment.
- Features such as decoration can attract tenants and improve salability in future.
- Building layout is important as it can help reduce maintenance and operating costs.

Investor

- A major concern for an investor is the *Present Value of Future Cash Flows*.
- Return on invested capital is a primary motivating factor.
- Future cash flows (*operations cash flow* and *sale proceeds cash flow*) are analyzed to make a buying decision.

Investors vs. User

- User groups are different from investor groups.
- The investment objectives are similar for both groups when it comes to decision making.
- The needs of the buyer must be understood, and these include investment objectives, physical requirements and financial requirements.
- *Investors*: Needs assessment requires proper analysis such as fulfillment of investment objectives, expected rate of return, period to hold investment, tax sheltering and long-term strategy to diversify real estate through leverage.

MiniCram

- *Users:* The most important factor is whether the property satisfies the requirements or not.

Risks in Decision Making

- *Three major factors in decision making are- (i) Needs, (ii) Risk, and (iii) Return*
- *Risk* refers to uncertainty, chance, exposure and vulnerability imposed on an investor, particularly financial loss that may occur.
- For real estate purposes, risk is based on fluctuations in the income stream and vulnerability of that stream to external influences such as market trends, availability of financing, degree of positive or negative *Leverage* and overall economic conditions.

    - *Financial Risks*: Interest rates and purchasing power of future dollars (inflation), etc.
    - *Market Risks*: Real estate markets and occupancy/vacancy rates, etc.
    - *Business Risks*: Taxation, slow economic activity and investment climate, etc.
    - *Building Risks*: Physical calamities, depreciation, building code restrictions, insufficient insurance coverage, etc.

Liquidity

- *Liquidity* refers to the ease by which assets can be readily converted into cash.
- Investment in short-term guaranteed investment certificates (GIC), funds in chequing accounts, savings accounts, etc. are generally considered highly liquid.
- Investment in long term bonds, mortgages and real estate ownership require time to liquidate.

4.3 Cash Flow

Return

- *Return* refers to the yield realized on an investment, which can be positive or negative.
- *Return OF Investment*: When the initial investment would return? The recapture of initial funds *at some future date* through cash flow.
- *Return ON Investment*: How much will be the return on invested capital? A return on funds invested through cash flow (operations or sale proceeds).

Cash Flow

- Cash flow refers to all monies flowing from an investment which can be positive or negative.

    - *Operations Cash Flow*: Refers to periodic income received from the operation of the investment. *Annual Debt Service* (mortgage payments) are subtracted from annual *Net Operating Income (NOI)* to get *Operations Cash Flow*.
    - *Sale Proceeds Cash Flow*: It represents the sale proceeds of the investment (reversion).

- *Cash Flow Before Taxes (CFBT*) when tax liability is not considered.
- *Cash Flow After Taxes (CFAT*) is the income after deducting taxes.
- During valuation process the appraisers give more importance to *Cash Flow After Taxes*.

MiniCram

3 Rules of Cash Flow

- *Rule 1*: Larger cash flow is better than smaller cash flow in a given time period.
- *Rule 2*: Today's cash flow is better than tomorrow's cash flow. Time is an important consideration in analysis Investors look at *Time Value of Money (TVM).* Two things are important – (i) amount of return and (ii) time taken to get that return.
- *Rule 3* – After tax cash flow is better than before tax cash flow. This is the best measure of cash flow realized.

4.4 Leverage

- *Leverage* refers to use of borrowed funds to make an investment in real property in the hopes of realizing a profit.
- Leverage is expressed as a percentage of loan amount to the value of the project.
- *Positive Leverage* happens when yield to the investor exceeds the overall rate of return as compared to a yield with no financing.
- *Neutral Leverage* (No Leverage) happens when no increase or decrease in yield by way of leverage.
- *Negative Leverage* happens when the use of borrowed funds results in a lower equity yield than the overall rate of return as compared to a yield with no financing.

Leverage and Risk

- Increased financing does not always provide attractive returns through positive leverage.
- Chances of negative cash flows are also there.
- An increase in interest rates may make the situation worse.
- The investor may have to use reserve financial resources to offset losses.
- Significant negative cash flows may also complicate problems if it is followed by loss of value.
- *Equity Elimination* happens when the mortgage exceeds the value of property.

4.5 Taxation

Tax Sheltering

- *Tax Sheltering* refers to a financial arrangement that results in reduction or elimination of certain taxes.
- Availability and reliability of income stream (operations cash flow),
- Opportunity to realize capital appreciation (sale proceeds cash flow),
- Leverage possible to maximize return on investment; and
- Tax considerations applicable to property.

Capital Cost Allowance

- The *Income Tax Act* provides for *Capital Cost Allowance (CCA)* on income producing property.
- This generally reduces payable taxes on operations cash flow as well as sale proceeds cash flow.
- *Capital Cost* of a property is what the buyer pays for the property.

MiniCram

- *Capital Cost Allowance (CCA)* is the maximum rate that the taxpayer can claim for depreciation for a specific class of asset determined by Canada Revenue Agency.
- Most buildings qualify for 4% CCA on a *Declining Balance* basis.
- The rate for office furniture and equipment is typically 20%.
- CCA is *not a cash flow* item but rather a matter of taxation and tax-deductible expenses.
- The amount of depreciation allowed depends on the class of assets.

CCA Calculation Methods

- *Declining Balance Method*: The capital cost of depreciable property declines by a set CCA rate every year and the balance declines.
  - *Half Year or 50% Rule*: One half of cost is permitted during the first year of purchase.

- *Straight Line Method*: The useful life of the depreciable assets is estimated and the annual CCA taken represents a pro-rated amount based on the estimate. The calculation of CCA for leasehold improvements paid by tenant uses the straight-line method.

Recapture of CCA

- *Recapture* occurs if the sale price of the property exceeds the original acquisition price and the value of improvements has been maintained or increased since acquisition.
- All or a portion of the CCA claimed must be added to form part of profit for that sale.
- *Terminal Loss* occurs when depreciable assets have no value remaining at the time of sale.

Back to Table of Contents

MiniCram

5. SELLING A BUSINESS

5.1 Business

Shares or Assets

- A business is any undertaking for the purpose of profit, including any interest in any such activities.
- Businesses are typically divided into categories for listing and selling purposes; e.g. manufacturing, retail, service, wholesale.
- *Sale of Shares*: If shares in a corporation are being sold, the buyer assumes all assets and liabilities and may use all assets of the corporation including the real property.
- *Sale of Assets*: If only assets of the business are sold, the seller is responsible for all payable debt but also gets all receivables.

Key Considerations

- *Financial Statements*: Financial statements such as profit and loss statement and statement of assets and liabilities of the business should be obtained from seller.
- *Retail Sales Tax*: The buyer must obtain a *Clearance Certificate* from the seller showing that HST has been paid. Exempted items such as chattels must be supported by *Exemption Certificate*.
- *Chattels and Fixtures*: A list of items included in the sale or excluded from sale should be obtained.
- *Lease of Premises*: A copy of lease of premises should be attached to the agreement as a schedule.
- *Franchise Documentation*: If the business is a franchise, a copy of the franchise agreement should be attached to agreement.
- *Licenses and Permits*: The buyer should make adequate arrangement to transfer applicable licenses or permits to continue the business.
- *Equipment Leases:* If any business equipment is not owned but is leased, the buyer needs to assume these leases.

Financing by Seller

- The sellers are typically required to finance the sale by way of *Seller Take Back (STB)* or *Vendor Take Back (VTB).*
- Business assets are the security for this type of financing.

- *Earnout:* This is a method of financing the sale of a business by the seller wherein the balance of payment is based on the actual performance of the business after closing.
- This is helpful in finding the difference between what the seller is asking and what the buyer wants to pay.
- Three types of Earnout calculations –
  - *Base Period Earnout:* Additional payments in excess of balance due on purchase, are paid as a proportion of the increase in profit, over and above the profit in the base year.
  - *Incremental Earnout:* Similar to Base Period approach except that additional payments over fixed debt are calculated on a proportion of the year-to-year increase, capitalizes at a pre-determined rate.

MiniCram

- *Cumulative Earnout:* This approach is based on total increase in earnings over the base year for the number of years of contract.

5.2 REBBA 2002 Requirements

Buyer Protection

- If a real estate brokerage is involved in the sale of a business, the buyer must receive the following documents, *prior* to a binding agreement:
  1. A profit and Loss statement for the preceding 12 months or since the seller acquired the business,
  2. A statement of Assets and Liabilities, and
  3. A list of items (e.g. fixtures and chattels) that are *not* included in the sale.
- The first and second requirements do not apply if the buyer signs a statement attesting to having received and read a *statement under oath (Affidavit)* from the seller as to various matters relating to the business:
  1. Terms and conditions under which the seller possesses the premises (owned or leased),
  2. Terms and conditions relating to any sublet of the premises,
  3. All liabilities of the business
  4. A statement that the seller has provided all books of account in his/her possession, or has refused to do so, or has no books.

Sale of Business Affidavit (OREA® Form 503)

- This *Affidavit* is completed by the seller when financial statements are not delivered to the buyer.
- This is done before a binding agreement is signed by the parties.
- The Affidavit has declaration from the seller regarding –

  - Ownership of the business
  - Whether the premises is owned or leased.
  - Whether or not any part of premises is sublet.
  - Liabilities of the business, if any.
  - If account books have been delivered to buyer, or will not be delivered, or account books do not exist; as the case may be.

- *Waiver*: The buyer signs the *Waiver* part of the *Affidavit* if he does not require the seller to comply with the REBBA 2002 requirements.

5.3 The Bulk Sales Act

- **The Bulk Sales Act was repealed in March 2017.**

5.4 Business Valuation

Valuation Methods

- *Direct Capitalization*: The *Net Operating Income* generated by the business is capitalized based on analysis of comparable sales.

- *Gross Profit Multiplier (GPM):* This method is used if cap rate is not available for comparable properties.

- *Weighted Average*: This method is used when the profits have varied over the past years. It is greater than the simple average indicating that the business has higher profits in the later years.

- *Discounted Cash Flow*: This method is useful when both the business and property are being sold. Value can be established by discounting cash flows on the business enterprise, as well as sale of the property.

Asset Valuation

- Businesses are sometimes sold simply based on assets without any regard to their performance.
- The buyers typically use this method to acquire only assets of the business.

- *Goodwill* is non-tangible aspect of business and may have some value based on performance and reputation.
- Inventory, equipment, fixtures and supplies are valued separately without considering operating income.

- CCA: Steps must be taken to allocate the purchase price to specific assets. The seller may want low value on assets while the buyer will want a higher value for *Capital Cost Allowance (CCA)* purposes.

- *Adjusted Book Value* approach is used when a business has marginal earning potential but notable retained earnings.

- *Retained Earnings* refer to value received in purchase of the business.

- The *Book Value* or *Fair Value* (Market Value) or a combination may be used to find out final estimate for bargaining purposes.
- Bargaining mainly ranges between *book value* and *fair value* for the assets.

5.5 Sale of a Franchise Business

Categories of Franchises

- *Retail*: Fast food chains, specialty food shops, automobile services, convenience stores, etc.
- *Business/Personal Services*: In-house cleaning services, security systems, car/truck rental, tax returns, real estate brokerage, employment services, education/training, etc.
- *Travel and Leisure*: Travel agencies, tanning parlours, hotel chains and campgrounds.

Advantages of Franchise Business

- The franchisor assists both in startup and ongoing operation.

MiniCram

- If the business of the franchisor expands, the franchisee also gets benefit in terms of increase in value.
- The franchisor provides a ready-made image, training for employees, business logo and marketing techniques.
- Group purchasing power of the franchisor lowers costs for the franchisee.

Disadvantages of Franchise Business

- Initial cost of purchasing an established franchise business may be quite high.
- Less freedom for the buyer because strict standards of the franchisor must be met.
- The franchisee may have to buy products only from the franchisor.
- Dispute resolution may be complex if the franchisor office is located at a distant place.

Franchise Agreement.

- Franchise documentation must be carefully reviewed by the buyer.
- The *Franchisor* may require approval of any agreement of purchase and sale.
- The franchisor may have taken *Head Lease* of the premises and the buyer may have to assume the sub-lease from franchisor.
- A copy of franchise agreement should be attached to the agreement of purchase and sale as a schedule.
- The buyer must also agree to the terms of franchise agreement.

Valuation

- The *Franchisor* charges a fee or other remuneration which must be considered during evaluation.
- The cost of franchising usually depends on market penetration.
- Royalties for on-going operations can be significant.

Back to Table of Contents

MiniCram

6. COMMERCIAL LEASING

6.1 Commercial Tenancies – Legal Issues

The Commercial Tenancies Act

- A commercial tenancy refers to any lease involving a property principally used for business purposes and is governed by the provincial *Commercial Tenancies Act*.
- At the end of the lease term, the tenant is required to transfer the *Leasehold Estate* back to the landlord.
- An *Agreement to Lease* is without a settled form of *Lease* and contains fundamental, material aspects of the agreement between the parties, but expects that a formal detailed lease would be signed.
- A copy of the *Lease* should be attached to the *Agreement to Lease* to eliminate any confusion between parties and to ensure that the tenant understands the terms of the final lease.
- *Hybrid Building*: A building with two stores on main level and two apartments upstairs would be considered commercial for main level and residential; for upper level.

Components of a Commercial Lease

- *Base Lease:* The base lease refers to a *General Form of Agreement* that applies to as many tenants in a complex and contains minimum rents, services provided and allocation of common areas to the tenants.
- *Schedules in a Lease:* Typical Schedules are –
  - *Schedule A* – Premises
  - *Schedule B* – Site Plan
  - *Schedule C* – Landlord's and Tenant's Work
  - *Schedule D* – Rules and Regulations

Assignment and Subletting

- The difference is based on *Privity,* which means that only parties to a contract can enforce it on each other.
- Typically, the tenant in commercial lease is not permitted to assign or sublet without the written consent of the landlord, which the landlord cannot withhold unreasonably.
- *Assignment:* If the tenant assigns the lease to a third party (*assignee*), then that third party establishes *Privity* with the landlord. The original tenant may remain in privity with the landlord, unless specifically released.
- *Subletting:* If the tenant only conveys a portion of its leasehold interest to a third party (*Subtenant*), the tenant remains in privity with landlord. There is no privity of contract between the landlord and the sub-tenant. Most commercial leases require the sub-tenant to covenant directly with the landlord so that the landlord may take legal action against the tenant or the sub-tenant.

Continuous Use vs. Dark Space

- A *Continuous Use* clause requires that the tenant continuously occupies the space, maintains substantial stock and fully staffs the business.
- *Dark Space* refers to a situation when the tenant leases a large space in a commercial complex, keeps on paying the rent but physically remains absent.

MiniCram

- *Dark Space* puts the landlord in a difficult situation if the tenant is an anchor tenant as other tenants would not be attracted to the complex.

Fixtures/Trade Fixtures

- *Most leases* provide that any *fixture* attached to the property becomes the property of the landlord at the time of installation.
- Unless a lease specifies otherwise, a tenant who installs a *trade fixture* to the property can remove it at the end of the lease term, provided that all rents have been paid in full.
- The tenant may also be required to bring the property back to its original condition and repair any damages.

Guarantor vs. Indemnifier

- *Guarantor*: A guarantor has limited liability and if the tenant files for bankruptcy, the guarantor is also released of his obligations.
- *Indemnifier:* Indemnifier is a covenantor in the same sense as the tenant and is liable even if the tenant files for bankruptcy.
- *Co-tenant*: The proposed guarantor or indemnifier becomes co-tenant and is jointly responsible for all obligations.

Restrictive Use and Exclusive Use

- *Restrictive Use* is a clause in the lease that limits or restricts the activities of the tenant as per the lease agreement.
- Landlords include restrictive clauses to ensure a mix of tenants in the shopping centre.
- In some cases, a tenant may request *Exclusive Use* to better ensure business volumes.

Rent and Non-payment of Rent

- *Interest on Deposit*: The landlord is also not required to pay interest on security deposits, unless otherwise agreed in lease.
- *Rent Increases*: The *Commercial Tenancies Act* does not regulate rent increases.
- *Non-Payment of Rent:* The landlord has two options –

  - *Change the Locks*: A landlord may change the locks of the unit on the 16th day after the due date. The landlord should not forcibly enter the premises and should allow the tenant to remove their property.

  - *Seize and Sell Tenant's Property*: The landlord may, without giving any further notice to the tenant, seize and dispose of tenant's property. Any surplus should be given back to the tenant. The landlord must notify the tenant of *distress* and the amount required to remedy before selling the assets. The landlord must also hold the property for minimum 5 days and get appraisal before selling. Subtenant's property cannot be seized or sold by the landlord if the sub-tenant is not in default of payments.

Rights and Obligations

- Tenants have the right to *Quiet Enjoyment* of leased property and are protected from direct or indirect interference or threats by the landlord.
- A breach of contract occurs if the landlord deprives the tenant of use of premises, provided the tenant is not in default.

MiniCram

- Landlords and tenants have the right to apply to *Superior Court of Justice* or *Small Claims Court* (for amounts of $25,000 or less) to seek damages in case of non-fulfillment of obligations under the lease.
- Landlords must notify the tenant in writing of specific breaches of the lease and allow a reasonable time to comply.
- The landlord may have the right to terminate lease if the tenant fails to fulfill obligations.
- Tenants must pay the rent on due date and *cannot hold back rent* when the landlord fails to fulfill obligations.

Termination of Lease

- *Month-to-Month*: Either the landlord or the tenant can terminate the tenancy with a minimum 1-month notice.
- *Fixed Term*: Once the tenancy ends, the tenant has no right to occupy the premises.
- *Overholding*: An *overholding* tenant may have to pay two months of rent for every month they occupy the premises after the lease has expired.

6.2 Types of Commercial Leases

Rent Calculations

- *Gross Lease*: The tenant pays a fixed rent and the owner pays all operating expense. This type of lease is not preferred by landlords.
- *Net Lease*: The tenant pays a part of expenses for the leased premises. Three types are -
  - *Net Lease*: The tenant pays rent and certain defined expenses.
  - *Net/Net Lease (Double Net*): The tenant pays maintenance (minor repairs) and operating expenses plus property taxes.
  - *Net/Net/Net Lease (Triple Net):* The tenant pays all expenses including major repairs, structural damage, etc. Also called *Carefree to the Landlord* Lease.

- *Base Rent*: This is the *minimum rent* and typically given as annual rent per square foot.
- *Additional Rent*: This represents the proportionate share of operating costs. Additional Rent is estimated as tenant's percentage area out of the *Total Rentable Area* of the building. The additional rent may not include all costs incurred by the landlord.
- *Percentage Lease):* This clause in typically found in retail leases. It requires that the tenant pays a fixed monthly rent plus a percentage of gross monthly income, *in excess of Base Sale,* calculated using the minimum rent.

Other Rental Topics

- *Advance Tax Payments*: Commercial leases have provisions for advance payment of property taxes to align with municipal tax payment dates.
- *Supplementary Rent*: This rent payment is typically based on *Consumer Price Index (CPI).* This may involve a percentage applied to *Base Minimum Rent* over the period of the lease, but tenants may negotiate a cap on such rent increments on annual basis.
- *Expense Pass Through*: In the expense pass-through clause, the landlord may have provision to charge the tenants for certain capital improvements.
- *Rent Concessions*: Rent concessions affect the cash flow of both the tenant and the landlord.

MiniCram

- Typically, the concessions involve –
  - Concessions for improvements performed by the tenant.
  - Rent-free period (for base rent only) at the start of tenancy, graduated rent increases, etc.
  - Preferred treatment to tenant such as reserved parking, increased parking, upgrades to leasehold improvements, etc.
  - Renewal privileges, right of first refusal, expansion or reduction of leased space.

6.3 Measurements

Measurement Terms

- Measurement are based on *Industrial Floor Measurement Standard* provided by *Building Owners and Managers Association (BOMA).*
- *Gross Building Area*: The total gross floor area of the building based on external measurements. Unenclosed areas are excluded. Up to 2% difference in measurement is permitted.
- *Gross Leasable Area*: Total floor area for occupancy and exclusive use of tenants.
- *Usable Area*: It is the actual floor area occupied by the tenant.
- *Rentable Area*: *Rentable Area* in an office lease is the *Usable Area* of the tenant plus an allocation of common areas such as lobby, janitorial, washrooms and electrical room. The *Rentable Area* is used for calculating rent.
- *R/U Factor:* The relationship between rentable and usable areas is called the *R/U Factor* or *Efficiency Factor*. Sometimes, it is also called *Add-on Factor*.
- *Loss Factor*: The difference between *Rentable Area* and *Usable Area*.

Common Area

- It involves all areas used by two or more tenants such as corridors, lobbies and stairways. This area is not under the control of any tenant
- *Common Area Maintenance (CAM)* is the landlord's costs to repair, maintain, supervise and administer common areas.
- The Common Area Maintenance (CAM) charges are pro-rated among all tenants and billed as *Additional Rent.*

6.4 Property Management

Functions of Property Management

- A commercial brokerage may be involved in management of a commercial complex.

- *Four Management Functions*: Property leasing, Rent collection, Payment of expenses, and Maintenance of the property.

- *Management Agreement*: This agreement sets out the roles and responsibilities of the owners and the property manager.

- *Maintenance Plan*: The property manager would develop a maintenance plan. This includes assessment of property needs, identification of staff requirements, time lines for repair jobs, and orderly upkeep of the property.

MiniCram

- *Budget*: Commonly used methods for budgeting are – Projection of annual and monthly Net Operating Income, Budget for annual and monthly cash flow Budget and budget for capital reserves.

- *Insurance*: Insurance coverage is required to provide protection to the building structure and management of the building.

- *Security*: The property management must take reasonable care to provide protection to the tenants. Elements of a modern security systems must include a good design, hardware, people and management.

- *Improving Relationships*: Property manager can help improve relationships between the owners and the tenants. Such activities include development of procedures, rules for using amenities in the building, establish tenant policies regarding rent collection, property damage, tenant complaints, etc.

Back to Table of Contents

MiniCram

7. THE AGREEMENT TO LEASE – COMMERCIAL

7.1 The Agreement to Lease

Agreements in Writing

- An *Agreement to Lease* is without a settled form of *Lease* but must contain essential elements of a lease so that it can be enforced.
- It contains fundamental, material aspects of the agreement between the parties, but expects that a formal detailed lease would be signed.
- *Statute of Frauds*: A lease of less than 3 years need not be in writing but that may not be a good practice for both the landlord and the tenant.
- *Doctrine of Part Performance*: This concept is considered by courts in case of a dispute, for contracts of land that are not in writing. When one party has actually performed part of the contract (e.g. the tenant occupied the premises and paid rent), and a clear evidence exists, a contract is deemed to exist.
- As per REBBA 2002, all contracts related to land must be in writing to be effective.
- Commercial rent is subject to HST and is *'In Addition To'* the amount of rent.

Different Forms

- *Short Form of Leases Act*: Lease agreements can also be prepared under this Act, which provides for standard short wording.
- *OREA® Form 510-Long Form* is suitable for most commercial leases involving a *Net Rent* and has provision for graduated rent increases.
- *OREA® Form 511-Short Form* is suitable for smaller leases involving a *Gross Rent*.
- *The Agreement to Lease* form does not include any provision for *Credit Check* of the tenant because the *Consumer Reporting Act* describes a consumer as someone not engaged in a business.

Rent Concessions

- Rent concessions affect the cash flow of the landlord and the tenant.
- Concessions include *Rent-Free Period,* graduated rents, etc.
- The landlord may also be willing to provide reserved parking, renewal privileges and rights regarding expansion or reduction of leased space.
- *Expense Stop*: Sets out maximum landlord contribution regarding concessions.
- *Early Occupancy:* The landlord may have some conditions such as the lease should have been signed, security deposit must have been paid, all landlord's work is done, and the tenant has obtained insurance, etc.

7.2 Lease Negotiations

Tenant Objectives.

- *Industrial Tenants* are focused on ceiling heights, clear floor area, floor load capacity, loading docks, office component and electrical/mechanical systems.
- *Retail Tenants* often look for demographics of area, traffic, visibility and location so that greater revenues may be generated.
- *Office Tenants* are mainly interested in good location, appearance, facilities, parking and security.

MiniCram

- Supply and demand of commercial space affect the rental rates in a particular neighbourhood.

Landlord's Perspective - Factors

- Increased income received from tenants provides additional cash flow which results more capital return and has positive effect on property value.
- The landlord is assured of continuous and long-term lease income.
- Well documented lease and sub-lease accurately defines tenant's obligations during the lease term to minimize landlord's work.

Tenant's Perspective - Factors

- The tenant needs a prime location, but ownership is impractical due to insufficient capital resources. Leasing may be seen as a method to utilize 100% financing.
- Leasing can provide a better financial picture, may utilize all financial resources and positively affects credit rating.
- Tenant can claim rent payments as an expense on the *Profit and Loss Statement* while mortgage payments would show as a *Liability* in the *Balance Sheet.*
- Default on a lease is usually not as serious as default on mortgage payments.
- Tenant saves himself from the responsibilities of property management.

Disadvantages of Leasing

- The tenants do not get any benefit of property value appreciation.
- The benefits of lease are limited to the term of the lease which may not be renewable.
- Tenant's clientele, reputation and image may be adversely affected if the tenant has to move.
- If rent increase is significant over the years of tenancy or at the time of renewal, the cash flows of the tenant may be negatively affected.

Difficulties of First Time Tenants

- Suitable location is difficult to find, and they may not have sufficient time to research different locations. Special facilities may not be available for first time tenant for their particular business operation. They may face strict credit checks and associated charges.
- First time tenants may not correctly estimate the different and variable costs incurred in running the business. They may underestimate the cost of fixtures, improvements or stocking.
- Even for similar commercial properties, the rental costs may vary considerably.
- Some tenants may want to do the finishing work themselves to save costs, but the landlord may not agree due to safety, standards and/or liability issues.
- While some landlords may be ready to give concession to first time tenants, most other Landlords prefer to lease the premises to well-established businesses. They want to maximize their cash flows, their return on investment and maintain a most appealing mix of tenants in the building.

Back to Table of Contents

8. UNDERSTANDING LEASE CLAUSES

8.1 Typical Clauses - Retail Lease

- *Parties to the Lease*: This clause identifies the landlord and the tenant. There must be at least two signatories, the landlord and the tenant. Also, it is possible to sign an agreement on behalf of "*A Corporation yet to be Formed".*
- *Intent of the Lease*: The landlord clearly states that the tenant will be responsible for all costs incurred in the operation of the business, excluding only the landlord's income taxes and financing.
- *Premises*: A *Site Plan* is usually attached as a schedule in the lease to specify the premises, location and dimensions. In case of a single purpose property, the entire premises or the building itself is leased, including the parking lot. Location is critical to the tenant in retail centres as they want to stay close to entrance, anchor tenants, reputed stores, etc.

Term

- A lease must have a date of commencement and an expiry date; otherwise it is void and cannot be enforced.
- The landlord *Demises the Premises* (transfers the premises) or *grants a lease* to the tenant for a certain period of time (term).
- The premises must revert to the landlord at the end of the term.
- If the lease contract does not provide for a reversion, then it is not a lease but may be considered a sale of the property.
- The commencement date of the lease and the start date for rent payment may not be the same. Some tenants require 30 to 60 days' time for installation of fixtures or stocking the store.
- In this case, the landlord wants to ensure that the lease is in effect when the tenant starts leasehold installations, even though he may be willing to provide a *Rent-Free period.*
- *Renewal:* This clause allows the tenant to renew the lease on terms to be negotiated.
- *Overholding:* This clause permits the tenant to remain in the premises and the landlord to receive income for a brief period following termination of lease term.

Opening

- *Deferment of Opening*: The landlord may require that the tenant adheres to an *Official Opening* date of the shopping center. Tenant also agrees to *defer* his store opening to align with landlord's official opening date without any penalty to the landlord.
- *Failure to Open*: If the tenant fails to open on the *Official Opening* date, the landlord may charge double rent, may claim additional payments and may even terminate the lease if the tenant does not open after a specified number of days.

Non-Completion of Premises

- This section is a must for the protection of those landlords who are involved in development projects because the landlord may fail to complete the project by the date agreed with the tenant.
- Failure to include such clause could leave the landlord open to lawsuits.
- Major tenants will frequently attempt to insert a penalty clause that provides payment of a fixed amount, should the landlord fail to complete the premises.

MiniCram

8.2 Rental Clauses

- *Rent-Free Period*: This clause permits the tenant to occupy the store 30 to 60 days in advance to complete its finishing, fixtures installation and stocking. The tenant must have executed the lease and arranged insurance coverage. Furthermore, the landlord may require approval of tenant's plans and a building permit.
- *Rentals Payable*: The rent in a shopping centre has two parts – The *Base Rent* or *Minimum Rent* and the *Additional Rent*.
- *Post-dated Cheques*: Monthly post-dated cheques are typically required to ensure prompt and regular payment of rent.
- *Tenant's Proportionate Share*: The proportionate share of *Total Rentable Area* of the building is used to calculate the *Additional Rent*.
- *Advance Rent:* The first and last month's rent (sometimes last two months' rent) rent is paid in advance. Interest on this deposit is negotiable.
- *Other Payments*: The lease may require tenants to pay for various expenses which are other than the *Base Rent* and *Additional Rent* so that the landlord enjoys all accrued benefits of tenancy obligations.
- *Security Deposit:* This *additional security* is provided to the landlord over and above the rent deposit. Major tenants may not agree to such security deposit and smaller tenants may demand interest on such payments.

Percentage Rent

- The differing rates of percentage rent applied to various tenants usually reflect the level of their sales volume and the level of profitability of their business.
- Monthly sales figures allow the landlord to receive monthly interim cheques rather than waiting for the year end.
- *Sales Reporting*: This section allows the landlord to monitor tenant's success or probability of failure and helps evaluate the effectiveness of advertising.
- *Gross Sales Defined*: This section is included to limit the possibility of the tenant not including all sales from the premises, which would reduce the percentage rent obligation.

Tenant's Records

- This section permits the landlord to establish a monitoring system for reporting gross sales so that cash-based stores do not falsify their sales records to avoid percentage rent.
- Some stores such as fast food, convenience stores, variety stores, barbers, etc. have a higher proportion of gross sales generated through cash sales.
- Some leases contain a clause permitting the landlord to terminate the lease if the tenant does not achieve sales levels sufficient to provide a percentage rent payment.

Common Area Maintenance (CAM)

- *Landlord's Occupancy Costs* are specified in this section.
- This section permits the landlord to transfer every cost incurred in the operation of the shopping centre to the tenants.
- The landlord may recover the cost of any reasonable item required for operation of the shopping centre.
- In addition to cost of smaller items such as salaries of administration staff, the cost of major repairs such as repaving, a new roof or other major renovations may also be included.

MiniCram

Conduct of Business

- The landlord tries to keep best possible control over operation of the shopping centre to ensure that the tenants achieve high sales volumes. This results in increased percentage rent payment to the landlord.
- The landlord may consent to extended shopping hours for certain stores such as convenience stores, restaurants, etc.
- They will calculate additional costs of operating the centre and divide it among those stores that remain open late.

Use of Premises

- Each and every tenant operates its business within a narrowly defined store type. Precise limitation of uses is common with smaller tenants, but anchor tenants will demand least limitations on their use. Landlords insert this clause to ensure a mix of tenants in the shopping centre.
- *Exclusive Use*: Tenants may sometimes seek *Exclusive Use*. It is a dangerous element of lease and is never a part of the lease produced by a landlord. The *Exclusive Use* grants one tenant a use that prohibits a similar use anywhere else in the centre. In large centres, the landlord may refuse smaller tenants any *Exclusive Use*.
- *Restricted Uses*: This section has a list of uses that the landlord will automatically refuse. Any *Exclusive Use* granted to a specific tenant also becomes a *Restricted Use* for all other tenants.

Insurance

- *Landlord's Insurance:* The landlord insures for every possible eventuality, including rental insurance to pay for the loss from non-payment of rent in the event of damage to the building.
- *Tenants Insurance:* The tenants insure against three main elements – (i) Loss of income; (ii) Damage to their stock, improvements and fixtures; and (iii) Any damage to the premises that requires the tenant to repair.
- *Higher Risk Business:* The tenant is also directly chargeable for higher premiums if their business produces higher than normal risk.

8.3 Repairs and Alterations

Repair of the Premises

- Maintenance of major components of the building structure is landlord's responsibility and this includes roof, structure, bearing walls, etc.
- The landlord may charge back the cost of repairs to the tenants in *Common Area Maintenance (CAM)* charges.
- The tenant is responsible to repair the interior of their premises and maintain hygienic conditions.

Alterations to the Premises

- The landlord insists on full control of any alteration in the premises that the tenant desires and may not allow the tenant to do any alterations without permission of the landlord.
- Any work that involves the building structure or the roof is performed by landlord's contractors and be paid by the tenant.

MiniCram

Changes and Additions to the Retail Centre

- Since no one can expect or foresee what changes may occur in future, this clause is extremely important for landlords. The landlord should be able to alter the design, coverage and area of premises, at its own discretion.
- After commencement of lease, the governing document is the lease, but even then, the landlord may have reserved the right to relocate the tenant or alter its premises.
- The tenant may get the only right to terminate the lease if the changes do not fit its requirements.
- But major tenants may require that the landlord gets their consent for any such changes.

Damage and Destruction

- When significant damage occurs to the shopping centre, the rental units may no longer be able to generate profit.
- The landlord would largely be covered by insurance, except for the *Percentage Rent.*
- The tenants want an assurance that the landlord would carry out the repair work as early as possible so that they may resume their business.
- *Abatement of Rent*: In certain commercial leases, the landlord may agree to reduce the tenant's rent when the property is damaged, and the tenant is not able to carry out its business from the premises for more than 10 days. This provision applies only if the damage is not due to fault or negligence of the tenant.

Expropriation

- When expropriation occurs, the landlord and the tenant each have their separate rights to compensation, and these should not be merged.
- Expropriations that substantially limit or restrict the operable capacity of a shopping centre, office building or major industrial building are very rare because of high compensation costs.

Promotion

- *Merchants Association*: In this method, the landlord typically contributes 25% to 35% to the cost of promoting and advertising the shopping centre.
- *Promotion Funds:* Most landlords prefer this method because the advertising expenses are paid by the tenants and the money is spent by the landlord at its discretion.

8.4 Breach of Contract

Abandonment

- Under the *Critical Bankruptcy* elements of the tenancy, the landlord may act even when the tenant has not breached the contract, but clear reasons exist that he intends to breach.
- Some indications of a tenant who intends to breach include –

  - Consistent reduction in stock or staff,
  - Irregular or late rental payments,
  - Lesser interior maintenance,
  - Consistent reduction in advertising, or
  - Questionable sales.

MiniCram

- If the landlord can prove that the tenant has clear intentions to abandon the premises or when the tenant has actually abandoned, the entire remaining rent and additional rent, for the remaining term, becomes due and payable.
- As a result, the landlord may enter and seize the assets and has the right to *distrain* (sell) the tenant's property.

No Encumbrances

- The landlord wants to ensure that the fixtures and equipment in the leased premises do not have any encumbrances/liens and there is no mortgage or financing against the lease.
- This is to make sure that the landlord gets additional security in the event of breach by the tenant.

Right to Relet

- When the tenant has abandoned the premises, the landlord may want to relet the premises to maintain high occupancy levels.
- In this section of lease, a method is set so that the landlord tries to *Mitigate the Damage* (tries to reduce the debt of the defaulting tenant).
- If the landlord is successful in leasing the premises again at a higher rate, he would only charge administration expenses from the defaulting tenant.

8.5 Miscellaneous Clauses

Assignment or Subletting

- In case of an assignment or subletting, a different tenant (an individual or a corporation) assumes the lease. The landlord may have reserved the right to terminate the original tenant's lease when faced with such a request.
- Major tenants will normally demand the right to assign or sublet.
- The landlord wants to ensure that if consent for assignment or subletting is granted, strict provisions are included in the lease, such as a guarantee of the provisions of the lease.
- The landlord ensures that if the original tenant receives any benefit from the assignment or subletting, the benefits go to the landlord.

Non-Competition (The *Radius* Clause)

- The landlord wishes to secure the highest possible sales and restrict a tenant from opening another similar branch, or similar store, within the immediate vicinity of the shopping centre.
- This helps ensure that the tenant generates maximum sales from this very location, resulting in higher percentage rentals for the landlord.
- Conversely, anchor tenants may impose a similar restriction on the landlord where the landlord may not develop another shopping centre in a defined radius.

Back to Table of Contents

MiniCram

9. TRENDS AND COMMON ISSUES

9.1 Due Diligence

Fact Finding

- *Due Diligence* refers to verification of relevant information about a real estate transaction.
- It typically focuses on financial, legal, structural and environmental matters related to the subject property.
- Agreements usually provide a month or more to the buyer to access and analyze related information obtained from the seller as well as from public sources.
- The buyer usually has the right to terminate the agreement if the facts discovered do not meet expectations.

Scope of Analysis

- Document analysis is done to have full knowledge of relevant facts and the scope of analysis varies with the type of subject property under consideration.
- Different types of properties need different documents and time. No standard clause exists.
    - ➢ *Financial/Operational*: The documents include income statements, balance sheets, bank statements, rent rolls, lease contracts, tax bills, employee records and details of operating expenses, etc.
    - ➢ *Legal*: Analysis includes title search, assets and liabilities, outstanding mortgages or other encumbrances, surveys, licenses, contracts, permits and zoning compliance.
    - ➢ *Structural*: Commercial buildings are inspected in accordance with the standards of *ASTM International (American Society of Testing and Materials)*. Building inspection is done to identify physical deficiencies. The inspection report includes items that need immediate repairs, excluding any regular maintenance.

Environmental Assessment

- *Environmental Audit* of a commercial property may be required before a binding agreement and it is an important part of *Due Diligence.*
- Environmental hazards or contamination may be a significant risk to human health or life.
- Environmental analysis is done in three phases -
    - ➢ *Phase 1 Audit:* Visual inspection of property and review of documents (registry information, records from *Ministry of Environment*, certificates, etc.) is done in this phase to determine whether or not any contamination is there.
    - ➢ *Phase 2 Audit:* Samples of soil, water and hazardous waste are taken, and tests/analysis are conducted to determine the scope of contamination.
    - ➢ *Phase 3 Audit:* Remedial steps (*corrective action*) are performed in this stage to remove contamination.

9.2 Site Selection and Brownfields

Site Selection

- *Economic Development Offices*: These offices have information on available real estate inventory (vacant land or buildings). This information is helpful to those who are looking for commercial sites for development.

MiniCram

- *Economic Development Officer* can help with the following –
  - Guide the application and approval process through municipalities.
  - Provide information about incentives available from federal, provincial or local governments.
  - Registrants can find abundant information for their out-of-town clients who are searching for local sites for development.

Typical Site-Specific Factors

- Details regarding price, geographic location, frontage and total area.
- Zoning requirements related to permitted uses, setbacks, maximum coverage and height restrictions.
- Soil conditions, topography, terrain, environmental factors, physical barriers, need for fill or water retention method.
- Transportation, condition of access roads, costs of rail access, parking requirements, and future municipal expansion plans.
- Availability and cost of services such as water supply, storm and sanitary sewer, electricity and natural gas, fuel delivery and communication facilities.

Brownfields

- *Brownfields* are abandoned or contaminated lands which have the advantage of in-place infrastructure such as roads, utilities, water/sewer servicing, schools and transit facilities.
- *Ontario Brownfields Statute Law Amendment* provides for redevelopment and revitalization of *Brownfields*.
- It made amendments to the *Planning Act* and the *Municipal Act* to facilitate such activities.
- The objectives achieved by the legislation include assessment of valuable land resources for remediation and redevelopment.
- They address liability issues and provide for municipalities to grant financial incentives and tax relief.
- As per the Environmental Protection Act, the following conditions must be met in order to receive protection from future clean-up orders –

  - *Site Assessment*: The property must still meet site assessment standards in order to avoid future Ministry of Environment orders.
  - *Standards*: The property must meet soil, ground water and sediment standards for intended use.
  - *Record of Site Conditions*: Preparation and filing of this report is required.

9.3 Capital Gains Tax

Capital Gain

- *Capital Gain* is realized from the sale of *Capital Property (including real property)*, a percentage of which must be added to taxable income.
- The taxpayer is responsible for reporting the gain as regular income or as capital gain.
- If challenged by *Canada Revenue Agency,* the responsibility of proof is on the taxpayer.
- The *Tax Court of Canada* hears appeals in this regard and investigates the conduct of the taxpayer before, during and after the taxation period.

Key Factors

- *Intention*: The taxpayer's intention at the time of purchase is a key issue. If a property is purchased for investment, the resale profit *may still be* considered as ordinary income.
- *Relationship to the Taxpayer's Business*: The profits may be considered normal income when a taxpayer uses expertise acquired in regular business to earn profit on purchase/sale. Real estate transactions of contractors, renovators, real estate registrants, mortgage agents and appraisers are typically scrutinized very closely.
- *Frequency of Transaction*: How often the taxpayer engages in the sale of capital property is assessed.
- *Nature of Transaction and Assets*: If the asset cannot normally be used either personally or for investment purposes, the gain may be considered as regular business income.
- *Objects of the Corporation*: The *Article of Incorporation* is studied to determine if the transaction falls under the objects of the corporation and its usual business.

Exemptions for Principal Residence

- *Principal Residences* may have exemption from *Capital Gains Tax*. Registrants should seek expert advice on these matters.
- A *Principal Residence* must meet the following qualifying criteria –

  - The housing unit is owned solely or jointly by the taxpayer,
  - The land cannot exceed one acre,
  - The housing unit must be ordinarily occupied during the year by the taxpayer, and
  - The unit must be designated as taxpayer's principal residence for the year.

Real Estate Transactions

- If the taxpayer regularly buys and sells real estate, the profit from sale would *likely be* taxed as regular income
- If the taxpayer can prove that the transactions were planned and necessary part of total investment program, there *may be* a case for *Capital Gain.*
- In case of farmland, if the taxpayer has purchased it or inherited and lived on it, then the gain *may be* considered *Capital Gain*.
- If a sale is not planned, brokers are not involved in sale, the property is not advertised, there is no evidence of active marketing, then the profit from sale *may be*, *but not always*, treated as capital gain.
- If a taxpayer had purchased the property for a third party without expecting profit but that party backed out of deal and the taxpayer had to sell it, there *may be* a case for *Capital Gain*.

9.4 Bankruptcy

The Bankruptcy and Insolvency Act

- *Insolvent or Bankrupt* is a person or a company who is unable to meet debt obligations.
- The federal *Bankruptcy and Insolvency Act (BIA)* describes *Bankruptcy* procedures, a legal process which discharges most debts subject to certain conditions.
- The Act applies to individuals, sole proprietors, partnerships and corporations.
- Some debts are not released such as a student loan, claim for alimony, spousal or child support, a debt due to fraud, a court fine, and an award for damages involving an assault.

MiniCram

- The debtor under bankruptcy hands over assets to a *Trustee in Bankruptcy* to dispose of and distribute the funds to creditors.
- Creditors cannot take any further action against the bankrupt individual or company.

Discharge

- First time bankrupts are usually discharged after nine months, unless the discharge is opposed by creditors, the trustee or the *Superintendent of Bankruptcy*.
- In that case a court hearing would be required. The court may provide any of three types of discharge -
  - *Absolute Discharge:* The bankrupt individual is fully discharged.
  - *Conditional Discharge:* Certain conditions must be met before an *Absolute Discharge* is granted.
  - *Suspended Discharge:* The *Absolute Discharge* is effective from a future date.

Proposal

- The purpose of a *Proposal* is to reduce or settle a debt in order to avoid *Bankruptcy*.
- An individual or a company that owes between $1,000 and $75,000 can make an offer to the creditors to settle the debt.
- The proposal sets out debtor's strategy to creditors for reducing the debt and extending the time period for repayment.

Bankruptcy

- *Trustee in Bankruptcy:* A *Trustee in Bankruptcy* must first meet the individual or a company to assess various options. They are responsible to maintain contact with the bankrupt individual/company.
- *Receivership (Companies):* A *Receiver* is appointed by the creditors or by court order in order to manage company's assets for winding down the operation. The Receiver sells assets by tender, auction or other process on '*as is', 'where is'* basis.
- *Bankrupt Commercial Tenant*: Salespersons and brokers need to be aware that the landlord's right to distrain (sale of assets) for non-payment of rent is directly impacted as creditors gain priority under the BIA over the landlord.

Vesting Order

- A *Vesting Order* makes the sale of assets exempt from the *Bulk Sales Act*.
- This court order provides the buyer with court sanctioned possession, control and title of the property.
- It removes listed credit claims and outstanding encumbrances or liens on the property.

9.4 Municipal Tax Sales

Tax Arrears Certificate

- *Municipal Tax Sale* occurs when a property owner is in arrears of property tax. The property tax remains unpaid as of January 1st of the year following the tax year.
- A *Tax Arrears Certificate* is issued by the municipality against the title on the January 1st of 3rd year after taxes become owing.

MiniCram

- It is registered in the *Land Registry Office* and a notice is sent within 60 days to the owner, and other persons who have interest in property.
- The owner can cancel it by paying the *Cancellation Price* given in the certificate. It includes the amount of tax in arrears, current tax, interest and penalties.
- If payment is made by the owner the municipality must register a *Tax Arrears Cancellation Certificate,* which is a proof of payment.

Public Sale of the Property

- A public sale of the property is conducted if payment is not received within one year of registration of the *Tax Arrears Certificate*.
- The property may be sold either by *Public Tender* or by *Public Auction*.
- The *Public Tender* method sets out minimum tender amount. 20% of the tendered price is payable at the time of submitting the tender and the balance is due within 14 days of acceptance.
- If a *Public Auction* is held, it is subject to a minimum bid. The highest bidder must pay the bid amount, the *Land Transfer Tax* and accumulated taxes to the auctioneer.

9.5 Commercial Ownership

Sole Proprietorship

- *Sole Proprietorship* is a business undertaking owned and managed by a single person.
- This business operation can be started immediately with little paperwork, start-up costs are low and tax advantages also exist.

- Disadvantages -

    - Limited capital investment results in low borrowing power, unlimited liability in case of bankruptcy and right of creditors to seize personal assets in the event of default.
    - The owner is responsible for all debts, is entitled to profits but is also liable for all losses.
    - There is no separation between personal income and business income.
    - Sole proprietorship lacks continuity as 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.
- A *Partnership Agreement* is signed and is governed under the *Common Law*. Mere sharing of business efforts and profits may not constitute a *Partnership*.
- Partnership is personal in nature and all partners are *jointly and severally* liable for the actions of one another.
- A partnership must not be confused with a corporation and is not a limited company.
- Each partner is personally responsible to report the profits or losses for taxation purposes.

Limited Partnership

- A *Limited Partnership* is registered under the *Limited Partnerships Act*.
- It 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*.

MiniCram

- 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 *Article of Incorporation*.
- Debts of the corporation are distinct from the shareholders unless an agreement is signed for personal guarantee or liability.

Joint Venture

- *Joint Venture* refers to 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.

Trust Ownership

- 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.*

    - *Testamentary Trusts* take effect upon the death of the *Trustor.*
    - *Inter-vivos Trust* is effective while the *Trustor* is alive.
    - *Family Trust* is meant to protect an estate for the benefit of children in future.

- Types of beneficiaries –

    - *Income Beneficiaries* receive income from the trust.
    - *Capital Beneficiaries* who receive benefits from income, the sale of assets, or both.

Real Estate Investment Trust (REIT)

- REIT arrangement utilizes capital from various investors in the acquisition or financing of real estate.
- An REIT is not subject to income tax if it distributes entire annual income to its unit holders.

- Typical Real Estate Investment Trusts are –
    - *Equity REIT:* This REIT is focused on property ownership such as acquisition of shopping centres, office buildings, warehouses, etc.
    - *Mortgage (REIT):* This REIT focuses its activities in mortgage financing. This is also known as *Mortgage Trust*.

Agreement of Purchase and Sale – Commercial

- It is possible for a buyer to purchase a commercial property in the name of a trust, for a corporation, which is not yet registered.
- Registrants need to be aware that the seller must seek expert advice in such a situation.
- In case of non-completion of the sale, there may not be a legal recourse for the seller against the buyer.
- Certain entities may try to avoid liability by purchasing a property using the buyer name as '*In Trust for a Corporation yet to be Formed'* in order to avoid liability.

Back to Table of Contents

MiniCram

10. COMMON ERRORS

10.1 Inaccurate/Incomplete Information

Non-Disclosure of Material Facts

- *REBBA 2002 Code of Ethics* requires that *Competent and Conscientious Service* must be provided to clients and customers. Registrants must take reasonable steps to determine and disclose material facts about the property. Registrants may face complaints or lawsuits when a buyer discovers defects in a property after closing.
- Examples of facts related to property include roof leakage, problems with mechanical or HVAC systems, environmental hazards and incorrect building measurements.
  - *Latent Defects:* Physical deficiencies or defects which are not readily observable through reasonable inspection.
  - *Material Latent Defects:* Deficiencies that do not satisfy buyer's intended purpose, make the property dangerous, makes it unfit for habitation, or the improvements lack requisite permits or are not in compliance with municipal requirements.

Risk from Client's Perspective

- *Seller's Perspective*: Relying on seller's statements, non-verification of facts, not inspecting the property, not discussing seller's legal obligations to disclose *latent* and *material latent* defects, making assumptions about facts, failing to immediately resolve issues and failing to include a condition that may instead protect the buyer.
- *Buyer's Perspective*: Failing to include requirement of due diligence documents, not advising a thorough property inspection and not encouraging the buyer to seek expert advice on due diligence matters.

Minimizing Risk

- *Inquire*: Ask questions concerning roofs, water seepage, condition of HVAC, plumbing and electrical systems.
- *Investigate*: Conduct personal inspection of all above items.
- *Verify*: Point out any deficiencies to the seller and request additional information.
- *Disclose*: Disclose the existence of these material latent defects to the buyer and allow the buyer sufficient time to further investigate.

10.2 Inadequate Documentation

Paper Trail

- Registrants must maintain record of trade related documents as evidence to support their past conduct.
- Personal filing system, copies of trade documents, electronic planner system and making notes about showings and maintaining a paper-based message log of emails help reduce *Errors and Omissions* risk.

Marketing Documents

- *Confidentiality Agreement:* This agreement is used by brokerages for commercial transactions to safeguard confidential information of the clients. In the event of breach of agreement there is a provision that the injured party may seek damages through court.

MiniCram

- *Pro Forma (According to Form) Statement:* These are estimated financial statements prepared by a brokerage and concentrates on projected cash flow, before or after taxes. They are for general guidance only and should include an appropriate *Disclaimer*, *assumptions* and *limitations*.

10.3 Environmental Issues

Risk Factors

- Failing to discuss environmental issues with buyers/sellers (without providing any expert advice).
- Disregarding or ignoring the visual clues of contamination.
- Not enquiring or investigating current and past uses of the property.
- Not recommending expert advice and not including appropriate clauses in the agreement.

Properties That May Have Contamination

- Gas stations, dry-cleaning facilities and auto repair shops.
- Rail yards, refineries and landfill sites.
- Vacant land with odorous and/or discoloured surface water.
- Land that has debris all over or that has lower grade level than adjacent potential source of contamination.
- Indications of underground buried materials or bulk metal storage.
- Abandoned structures or structures where the use was changed after initial construction.
- Knowledge of past use of land which is being sold as development land.

Environmental Insurance

- Insurance coverage involves third party liability, cleanup and remediation costs, interrupted business operations, and legal expenses.
- A lender taking control of a mortgaged property under default may be held liable under provincial environmental legislation (*Environmental Protection Act*) for the pollution on the possessed land.
- Further, buyers can face liability for environmental hazards after buying the property.

10.4 Taxation

Harmonized Sales Tax (HST)

- Risk increases when the registrants assume that a specific property is exempt from HST.
- Tax applies to most real estate transactions, unless a specific exemption exists. Most commercial sales and leases are taxable.
- Charitable and non-profit organizations, hospitals and educational institutions are exempted from HST. Most residential resales and residential rentals are also exempted.
- The seller is responsible to remit taxes on sale and the tax must be collected from the buyer at the time of sale.
- The seller typically submits tax payment to CRA with his/her own HST return and the buyer may claim an *Input Tax Credit*.
- A *Mixed-Use* property (*hybrid building*) that contains both residential and commercial uses is viewed as taxable for commercial purposes but exempt for residential purposes.

MiniCram

- *Retail Sales Tax* is levied on fair value of tangible personal property such as chattels. It is not applicable to real property, fixtures or rentals.

Non-Resident Sales

- *Non-resident* sellers must remit the *Capital Gains Tax* on sale within 10 days of closing.
- The seller may remit the tax in advance, get a certificate from the *Minister of Revenue* and deliver it to buyer.
- The seller may give credit to the buyer for the tax amount because the buyer ultimately becomes responsible if the seller fails to pay.

Property Tax

- Registrants must obtain correct information on property taxes.
- Assessments are annually done by *Municipal Property Assessment Corporation (MPAC).*
- If the owners do not agree with the assessment value, they have two options to appeal –
  - *Request for Reconsideration (RFR)* can be filed with MPAC.
  - An appeal may also be made with *Assessment Review Board (ARB).*

Special Assessments

- *Special Assessment* is a financial levy on those properties that directly benefit from the special assessment.
- *Local Improvement Tax:* This tax is levied in a neighbourhood for improvements such as installation of new curbs and sidewalks.
- *Condominiums*: A *Special Assessment* is made when the corporation does not have sufficient money in *Reserve Fund* for necessary repairs/replacement of common elements. All unit owner must pay according to their proportionate share.

10.5 Easement Descriptions

Survey vs. Vague Descriptions

- *Errors and Omissions* risk increases when the registrant does not make efforts to enquire about known easements.
- Vague descriptions of the property or reliance on old surveys poses significant risk.
- Registrants must confirm property details through source documents such as *Survey* or *Title/Deed*.
- An up-to-date survey will not only show property boundaries and building location but also registered easements. An old survey may not show recent changes to the property.
- A condition should be added to agreement requiring the seller to provide an up-to-date survey.

Limitations on Use

- An easement is usually registered on the title of both properties – the *Dominant Tenement* and the *Servient Tenement.*
- In case the subject property is a servient tenement, the easement may impose restrictions on property use and can affect its market value.
- Further, a single property may be subject to several easements.
- Properly documented easements help minimize risks.

MiniCram

10.6 Zoning

Rezoning and Minor Variances

- Registrants can reduce *Errors and Omissions* risk by – (i) awareness of zoning by-laws, (ii) properly investigating permitted uses, and (iii) time and complexities involved in rezoning applications for change of use.
- Applications for *Rezoning* and *Minor Variance* are made to the local *Committee of Adjustment*.
- The municipality may decide to approve, make changes or reject the application and it may take anywhere from 4 to 6 months' time.
  - ➢ *Rezoning* is necessary if the buyer wants a different use than currently permitted in the zoning by-law. The *By-Law Amendment* application is considered only if the new use is still consistent with the *Official Plan.*
  - ➢ *Minor Variance* application is needed when a change in current use does not align with the zoning by-law, but generally adheres to its intent.

Non-Conforming Use

- A *Non-Conforming Use* is that which does not comply with and is prohibited under the present zoning.
- This typically occurs when the municipality makes changes to zoning.
- *Legal Non-Conforming Use* refers to a use which existed before the passage of a zoning by-law, but it is allowed to continue.
- *Continuous Use:* A *Legal Non-Conforming Use* must be continuous with no interruptions. If interrupted, the *Legal Non-Conforming* status of the property is disturbed.

Demolition and Renovation

- Older downtown core areas typically undergo renovations, demolitions and expansions.
- Demolition: The new structure must conform to the current zoning by-law.
- Renovations: The *Legal Non-Conforming* status is not changed.

Expansion

- When expanding the current structure, the municipality compares the current use with the intended use.
- Expansion may not be permitted if it creates a new non-conformity.
- Decision for approval of extension depends on three factors –

  - ➢ Significant change from existing use,
  - ➢ Impact on the adjacent properties regarding traffic, noise, etc., and
  - ➢ The interests of the community.

[Back to Table of Contents]

MiniCram

11. REGSITRATION AS A SALESPERSON

11.1 Working with a Brokerage

Employee vs. Independent Contractor

- All real estate salespersons and brokers are treated as *Employees* of the brokerage as per REBBA 2002.
- The difference between an *Employee* and an *Independent Contractor* is only for the purposes of taxation.
- The brokerage is responsible to advise, counsel, instruct and assist salesperson in performance of duties.
- The brokerage is responsible for trading activities of its employee salespersons and brokers.

Employee Status

- The brokerage normally bears the operating expenses and the salesperson does not pay any desk fee.
- Salespersons have to pay their own RECO registration fees and insurance premiums.
- Salespersons either get a fixed salary or salary plus commission.
- Some employee benefits may also be available such as *Employment Insurance*, *Canada Pension Plan*, group medical benefits, etc.
- Taxes are usually deducted at source.

Independent Contractor

- Salesperson agrees to pay desk fees, a percentage of commission (*commission split*) or flat fee, and other administration charges to the brokerage.
- Salesperson agrees to abide by brokerage rules and regulations for conducting business as given in the *Brokerage Policy Manual*.
- Salesperson also bears the expenses of maintaining their own registration, board memberships and educational courses.
- The commission charged by salespersons from clients is solely determined by them and belongs to the salesperson (subject to deductions).
- However, the total commission is first collected by the brokerage, distributed to any co-operating brokerage and then split with the salesperson.
- Independent Contractor salespersons are responsible for their own taxation matters and all personal expenses related to advertising, insurance, vehicle, etc.

RECO Registration Application

- The application must be complete in all respects, signed by the applicant and the *Broker of Record* before sending to RECO.
- Current or past bankruptcies or proposals must be disclosed in application.
- Similarly, any current or past criminal charges or convictions must also be disclosed.
- Application package includes completed application form, registration fees, transcript of the third course and a *Police Clearance Certificate* in original.
- After initial review and approval an invoice is sent to the brokerage and the applicant for payment of *RECO Insurance* premium.

MiniCram

- Once the insurance is paid, the salesperson is officially registered and ready to trade in real estate.
- RECO may obtain credit information of the applicant and may refer to a criminal search before approving the registration application.
- The most common cause of delay in review of application is an incomplete application.

Utilizing the Waiting Time

- Conduct market research in the local market regarding trends, prices, recent changes, new developments, etc.
- Attend training courses related to prospecting, listing presentations, qualifying buyers, negotiating skills, using the MLS ® system, etc.
- Learn as much as possible from other colleagues in office by making specific and general enquiries.
- Build a database of everyone you know e.g. your friends, acquaintances and business contacts.
- Drive around in your area and surveys all *For Sale*, *Sold* and *For Sale by Owner* signs.
- Prepare an effective *Listing Presentation* so you can be successful in the very first call from a prospective seller.

11.2 Prospecting Methods

Warm and Cold Calling

- A *Warm Call* refers to a call made to a known person and should be used effectively.
- A *Cold Call* is made to an unknown person and should be avoided in the beginning.
- New salespersons should focus on their sphere of influence (warm contacts).
- In the beginning, contacting known people and referrals is a good practice.
- The chances of rejection of a call in warm calling are much less than in cold calling.
- When making cold calls, the salespersons must not call any person who is on the *National Do Not Call List*.

Open House

- An open house is a warm prospecting technique.
- Salesperson may arrange an open house for any listing of the brokerage provided that the listing salesperson and the sellers agree.
- Open house is effective for 3 reasons –
  - Potential buyers get a chance to view the listed property,
  - The seller is convinced that the salesperson is making a sincere effort to sell the house, and
  - The salesperson gets the opportunity to meet new prospective buyers.

Private Sellers

- *For Sale by Owner (FSBO)* sellers are usually motivated to sell the property.
- Salespersons should keep in mind that these sellers might have had bad experiences with another salesperson or brokerage in the past.
- Some reasons why people want to sell privately include –
  - They may be thinking of saving commission which is actually the buyer's saving.

- They may be under an impression that they can negotiate better than any salesperson.
- They think that the right buyer will find their property.
- They are just trying for a month or so.
- They think that all they need is a lawn sign and are not aware of marketing exposure if the property is listed with a brokerage.

Expired Listings

- Expired listings are also an excellent source of business.
- The salesperson should keep in mind that they may get a negative response due to failure of the previous brokerage to sell the property.
- The seller might have been thinking that the brokerage did not do enough to sell the property while a high asking price could be the reason.
- Salespersons should not contact the seller of any expired listing if the listing contains specific instructions from the seller not to contact him after expiry.

11.3 Telemarketing

The National Do Not Call List (DNCL)

- *Cold calling* by real estate professionals is under federal legislation.
- Some exceptions apply such as *existing relationship* with the Brokerage.
- Salesperson may make a cold call to someone if he/she has specifically asked to contact him/her.
- Some people may allow a salesperson to call them when they visit their open houses.

Existing Relationship

- *6 Months* – If the person has made an enquiry.
- *18 Months* – If the person has purchased or rented property from the brokerage.
- *18 Months* – If the person had a written agreement with the brokerage, e.g. a *Listing Agreement* or a *Buyer Representation Agreement*.

11.4 Canada Anti-Spam Legislation (CASL)

- *Purpose*: To promote the efficiency and adaptability of Canadian economy by discouraging use of electronic means for –

  - Impairing availability, reliability, and optimal use of electronic media,
  - Imposing additional costs on businesses and consumers,
  - Compromising privacy and security of confidential information, and
  - Undermines the confidence of Canadians in the use of electronic means of communication for commercial activities.

Commercial Electronic Message (CEM)

- *CEM is a*n electronic message that asks for participation in some form of commercial activity.
- It includes messages related to real estate sales and promotion of goods, services, a specific individual or sale of real property.

- Messages include those sent to email addresses, Facebook accounts, Twitter accounts, telephone accounts and through *Instant Message* (IM) service.

Consent

- The sender of CEM must get consent (*written* or *implied*) of the recipient, identify himself/herself, get consent to send message, the specific purpose for which consent is requested, and provide a method to withdraw consent.
- If challenged, the responsibility of proof is on the sender.
- Express consent must be through *opt-in method* and not by *op-out method*.

- *Referrals:* Consent is not required if it is a simple referral from a business that has *existing relationship* with the consumer. Existing relationship refers to a business relationship or a non-business relationship with the past 2 years.

- *Penalties:* Penalty for violation could be up to $1 million for an individual and up to $10 million for a business.

Exceptions

- CASL does not apply to *Twitter* posts, *Facebook* wall posts, websites, blogs, two-way voice communication between individuals and, faxes and voice recordings sent to telephone accounts.

Back to Table of Contents

MiniCram

PART II – MATH CONCEPTS & COMMERCIAL AGREEMENTS

BASIC COMMERCIAL MATH

12.1 Building Cost Analysis

Floor Area Ratio (FAR)

FAR = Gross Floor Area ÷ Gross Lot Area

Gross Building Area = Gross Lot Area X FAR

► ***Note:*** *Floor Area Ratio is NOT a percentage.*

Example 1: If the lot size is 4,800 square feet and the total floor area is 12,480 square feet, what would be the floor area ratio?

FAR = 12,480 ÷ 4,800 = **2.6**

Example 2: If the lot size is 8,000 square feet and the floor area ratio in a particular zone is 3.25, what would be the maximum building size that can be built?

Building Size = 8000 X 3.25 = **26,000 Square Feet**

Buildable Land Cost

Buildable Land Cost = Total Land Cost ÷ Buildable Area

Example: An investor is looking to purchase 2.5 acres of land at the cost of $280,000 per acre. If the municipal zoning by-laws permit a maximum of 35% coverage, what would be his cost of land per buildable square foot? (1 Acre = 43,560 Square Feet)

Total Land Cost = 280,000 X 2.5 = $700,000

Total Area = 2.5 X 43,560 = 108,900 Square Feet

Buildable Land Area = 108,900 X 35% = 38,115 Square Feet

Buildable Land Cost = 700,000 ÷ 38,115 = **$18.37 Per Square Foot**

Design/Build: Return on Investment

Return = Rent ÷ Total Construction Cost X 100

Example: Investor Jim is analyzing a Design/Build option for his tenant client based on his return on investment in building costs. The selected parcel of land is 5 acres is size listed at $245,000 per acre. The zoning by-laws permit a maximum coverage of 40% of the total lot size. The soft cost is $10.50 per square foot; hard cost is $37.95 per square foot while the development cost per square foot is $12. If the tenant client is ready to pay annual rent of $9.50 per square foot, what would be Jim's return on investment? (1 Acre = 43,560 Square Feet)

Land Cost = 5 X 245,000 = $1,225,000

Buildable Area = 5 X 43,560 X 40% = 87,120 Square Feet

Buildable Land Cost = 1,225,000 ÷ 87,120 = $14.06 Per Square Foot

MiniCram

Construction Costs = 10.50 + 37.95 + 12 = $60.45 Per Square Foot

Total Land and Building Costs = 14.06 + 60.45 = $74.51 per Square Foot

Return on Investment = 9.50 ÷ 74.51 X 100 **= 12.75%**

12.2 Investment Properties

Leverage

Leverage Ratio = Mortgage Loan ÷ Value X 100

Example: Investor Jim has $750,000 equity available and is considering purchase of an office building for $2,275,000. The balance amount would be financed through a local lender. Calculate the leverage ratio.

Purchase Price (Value) = $2,275,000

Down Payment (Equity) = $750,000

Mortgage Loan = 2,275,000 – 750,000 = $1,525,000

Leverage Ratio = 1,525,000 ÷ 2,275,000 X 100 = **67%**

Cash Flow and Equity Return

1. Effective (Operating) Income = Potential Income – Loss%
2. Net Income = Effective Income – Operating Expenses
3. Cash Flow = Net Income – Annual Debt Service
4. Equity Return = Cash Flow ÷ Equity X 100
5. Overall Return = Net Income ÷ Purchase Price

Example 1: An investor is considering purchase of a commercial property for $1,020,000 with loan to value ratio of 70%. The loan amount is financed at an interest rate of 6.5% per annum, compounded semi-annually not in advance to be amortized over a period of 25 years. The monthly mortgage payment is estimated to be $4,782.54. The annual operating income of this property is 240,000 with annual operating expenses estimated to be 150,000. What would be the *Overall Rate of Return*, the *Cash Flow* and the *Return on Equity*?

<u>Part I</u>

Net Income = 240,000 – 150,000 = $90,000

Overall Return = 90,000 ÷ 1,020,000 X 100 = **8.82%**

<u>Part II</u>

Equity = 1,020,000 X 30% = $306,000

Annual Debt Service = 4,782.54 X 12 = $57,390.48

Cash Flow = 90,000 – 57,390.48 = **$32,609.52**

Equity Return = 32,609.52 ÷ 306,000 X 100 = **10.66%**

MiniCram

Example 2: Investor Bright is considering purchase of an apartment building having 65 units. The building is listed for $5,500,000 and Bright is ready to pay this price provided it meets his investment objectives. Bright has 35% equity available and will arrange a mortgage loan for the balance of purchase price. The mortgage will be interest only with an annual interest rate of 6.5% per annum with payment at the end of each year. The financial statements given by the seller provide the following information:

- The annual potential rental income is $1,050,000.
- The vacancy and bad debt is 4.5% of annual potential income.
- Other income from parking and laundry is $28,800.
- The annual operating expenses are 58.5% of the annual operating expenses.

Based on above information, what would be the *Return on Equity* from this purchase?

<u>Part I: Calculate Annual Debt Service</u>

Down Payment = 5,500,000 X 35% = $1,925,000

Mortgage Loan = 5,500,000 X 65% = $3,575,000

Annual Debt Service = 3,575,000 X 6.5% = $232,375

<u>Part II: Calculate Net Operating Income</u>

Operating Income = 1,050,000 – 4.5% + 28,800 = $1,031,550

Annual Expenses = 1,031,550 X 58.5% = $603,457

Net Income = 1,031,550 – 603,457 = $428,093

<u>Part III: Calculate Cash Flow and Equity Return</u>

Cash Flow = 428,093 – 232,375 = $195,718

Equity Return = 195,718 ÷ 1,925,000 X 100 = **10.17%**

12.3 Capital Cost Allowance

Capital Gains Tax

Capital Gain = Sale Price – Adjusted Cost Base – Cost of Sale

Taxable Capital Gain = Capital Gain X 50%

Example: A commercial building was purchased for $540,000 approximately 18 years ago. The buyers spent $150,000 on its renovations. The adjusted cost base was established at $870,000. The building was sold last year for $1,260,000. The cost of sale was $54,000 which included legal expenses and realty commissions.

What was the amount of Capital Gain and Taxable Capital Gain?

Capital Gain = 1,260,000 – 870,000 – 54,000 = **$336,000**

Taxable Capital Gain = 336,000 X 50% = **$168,000**

MiniCram

Declining Balance Method (*Half Year or 50% Rule*)

For New Business

1. Count the days in the Year of Incorporation
2. CCA for First Year = Cost of Purchase X CCA Rate X 50% X Days ÷ 365

For Existing Business

1. Calculate CCA on the Previous UCC using *Full* CCA Rate
2. Calculate CCA on New Purchase using *Half* CCA Rate
3. UCC for Jan 1st of Next Year = Previous UCC + New Purchase – Total CCA

Example 1: Owner Michael incorporated a business on August 30, 20xx (not a leap year) and purchase $18,000 worth of office equipment and furniture on September 15, 20xx. The CCA class for these items is 20%. Calculate the Capital Cost Allowance Michael can claim on his first-year tax return.

Number of Days in the days = 124 (August 30 to December 31)

CCA for First Year = 18,000 X 20% X 50% X 124 ÷ 365 = **$611.51**

► ***Note:*** *Ignore the date of purchase.*

Example 2: Cram Cookies Inc. started its bakery operations several years ago. As of January 1st, 2012, the company had equipment with undepreciated capital cost (UCC) of $24,600. On May 15th, 2012, Cram Bakery Inc. purchased additional equipment for $10,800. The CCA rate for this class of equipment was 20%. How much depreciation Cram Bakery Inc. had claimed on its 2012 tax return and what was the undepreciated capital cost as of December 31, 2013?

<u>Part I: Tax Year 2012</u>

Total Undepreciated Capital Cost = 24,600 + 10,800 = $35,400

CCA on Previous UCC Amount = 24,600 X 20% = $4,920

CCA on New Purchase in 2012 = 10,800 X 10% = $1,080

CCA for Year 2012 = 4,920 + 1,080 = **$6,000**

UCC as of December 31, 2012 = 35,400 – 6,000 = $29,400

<u>Part I: Tax Year 2013</u>

UCC as of Jan 1, 2013 = $29,400

CCA for 2013 = 29,400 X 20% = $5,880

UCC as of December 31, 2013 = 29,400 – 5,880 =**$23,520**

CCA For Properties (Land & Building)

Building Cost = Purchase Price – Land Price

MiniCram

► ***Note:*** *Land does not depreciate. CCA is only on Building and Improvements. Only the CCA Rate is different, the calculation is similar to Office Equipment and Furniture.*

Example: A commercial property is purchased in April 2012 for $1,560,000. The land and building allocation of the purchase price is 40/60. The CCA rate for the building and improvements is 4%. What would be the Undepreciated Capital Cost at the end of 2 years of ownership?

Building Cost = 1,560,000 X 60% = $936,000

CCA for Year 1 = 936,000 X 2% = $18,720

UCC for End of Year 1 = 936,000 – 18,720 = $917,280

CCA for Year 2 = 917,280 X 4% = $36,691

UCC for End of Year 2 = 917,280 – 36,691 = **$880,589**

► ***Quick Method****: 936,000 – 2% – 4% = $880,589.*

Recapture of CCA

- *Recapture* of all or part of CCA claimed occurs if the improvement allocation at the time of sale has been maintained or has increased since acquisition.
- If there is actual loss, the *Recapture* amount is Zero.

Example: Investor Ingrid purchases a commercial building five years ago for $2,440,000 with improvement allocation of 65%. The CCA rate for this type of building was 4%. During all these years a total of $265,877 has been claimed as CCA. She did not make any major capital improvements during the years of ownership. Ingrid sells the property now for 3,280,000 with improvement allocation of 60%.

What would be the Recapture of CCA on this sale of the property?

Improvement Allocation at the Time of Purchase

= 2,440,000 X 65% = $1,586,000

Improvement Allocation at the Time of Sale

= 3,280,000 X 60% = $1,968,000

The improvement allocation at the time of sale is greater than the allocation at the time of purchase.

The entire CCA amount $265,877 would be recaptured.

Recapture Amount = **$265,877.**

12.4 Commercial Leasing

R/U Factor

R/U Factor = Rentable Area ÷ Usable Area

Rentable Area = Usable Area X R/U Factor

MiniCram

Example: A commercial building has a total of 120,000 square feet of rentable area and 105,000 square feet of usable area. If a tenant has 3,680 square feet of usable area, what would be his rentable area rounded to nearest square foot?

R/U Factor = 120,000 ÷ 105,000 = 1.142857

Rentable Area for Tenant = 3,680 X 1.142857 = **4,206 Square Feet**

Base Minimum Rent

Base Minimum Rent = Rentable Area X Per Square Foot Rent

Example: A tenant leases a small office space with 1,450 square feet of usable area. The R/U factor for the building is 1.2691 for all tenants. The base minimum rent for the tenant is $12.50 per square foot per annum. What would be his monthly rent?

Rentable Area = 1,450 X 1.2691 = 1,840 Square Feet

Base Minimum Rent = 1,840 X 12.50 = $23,000

Monthly Rent = 23,000 ÷ 12 **= $1,916.67**

Additional Rent (Proportionate Share of Expenses)

<u>Method I</u> - Total Operating Expenses X Tenant's Percentage Area

<u>Method II</u> - Total Operating Expenses ÷ Total Area X Tenant's Area

► ***Note:*** *When using Method II, both areas must be similar, either both must be Rentable or both must be Usable*

Example: A tenant leases a retail unit in a shopping centre that has 140,000 square feet of rentable area and 122,000 of usable area. The tenant's usable area is 4,200 square feet. The total operating expenses for this shopping centre are estimated to be $2,226,500 annually. What would be the tenant's annual additional rent?

Additional Rent = 2,226,500 ÷ 122,000 X 4,200 = **$76,650**

► ***Note:*** *Use Method II. Take the Usable Area as it is known for both the tenant and the shopping centre. Do not calculate the R/U factor or tenant's rentable area because it is not required for this question.*

Percentage Rent

1. Base Minimum Rent = Rentable Area X Minimum Rent PSF
2. Base Minimum Sale = Base Minimum Rent ÷ Percentage
3. Percentage of Sale = Gross Sale X Percentage
4. Percentage Rent = Percentage of Sale – Base Min Rent
5. Applicable Rent = Base Minimum Rent + Percentage Rent

MiniCram

► ***Notes:*** *a) Percentage Rent is applicable only if amount of Percentage of Sale is more than the Base Minimum Rent.*

b) If amount of Percentage of Sale is equal or less than the Base Minimum Rent, the Percentage Rent is not applicable.

c) Even if Percentage Rent is not applicable, the Applicable Rent is known as 'Total of Base Minimum and Percentage Rent'. In that case it will be same as Base Minimum Rent.

Example 1: The base minimum rent for a retail unit is $13.50 per square foot per annum. The percentage rent clause specifies 5.5% of gross annual sale over the base minimum. A tenant leases rentable area of 2,200 square feet unit in this shopping centre. The gross annual sale for the first year is expected to be $700,000. What would be the base minimum rent, the base sale amount and the percentage rent?

Base Minimum Rent = 2,200 X 13.50 = **$29,700**

Base Minimum Sale = 29,700 ÷ 5.5% = **$540,000**

► ***Note:*** *Percentage Rent is not payable if the Gross Sales do not exceed $540,000.*

Percentage of Gross Sales = 700,000 X 5.5% = $38,500

Rent Payable in the First Year = $38,500

► ***Note****: This is the 'Total of Base Minimum and Percentage Rent'.*

Percentage Rent = 38,500 – 29,700 = **$8,800**

Example 2: A tenant in a shopping centre is considering lease of a retail unit that has usable area of 1,400 square feet. The landlord calculates R/U factor based on total rentable area 8,400 square feet and total usable area of 7,240 square feet. The percentage lease clause provides for 5% of gross sales over the base minimum. The rent for the current year is $12.25 per square foot of rentable area. The tenant expects gross sales of $450,000 in the first year of operation. The total operating expenses for the shopping centre are estimated to be $115,500.

Based on the above information, calculate the following:

I. Tenant's Base Minimum Rent for the first year.

II. The Base Minimum Sale required to meet the percentage rent obligation.

III. The Total of Base Minimum and Percentage Rent.

IV. The Additional Rent payable per square foot of rentable area.

V. The Total Rent for the first year

Part I

R/U Factor = 8,400 ÷ 7,240 = 1.1602

Rentable Area for Tenant = 1,400 X 1.1602 = 1,624 Square Feet

Base Minimum Rent = 1,624 X 12.25 = **$19,894.**

Part II

Base Minimum Sale = 19,894 ÷ 5% = **$397,880.**

Part III

Percentage of Sale = 450,000 X 5% = $22,500

Total of Base Minimum and Percentage Rent = **$22,500**

► ***Note:*** *Percentage Rent = 22,500 – 19,894 = $2,606.*

Part IV

Additional Rent = 115,500 ÷ 8,400 X 1,624 = **$22,330**

Part V

Total Rent = Total of Base Minimum + Percentage Rent + Additional Rent

Total Rent = 19,894 + 2,606 + 22,230 = **$44,730**

Rent Concessions

Annual Rent = Base Min & Percentage Rent + Additional Rent – Concessions

Example: The rentable area leased by a retail tenant is 1,800 square feet with a base minimum rent of $12.50 per square foot per annum. The percentage rent is 4.5% of gross sales over the base minimum and it is expected to be $650,000. The landlord is willing to give $12,000 concession for tenant improvements in the leased unit and is also offering 3 month rent free period for base minimum rent only. The additional rent payable by the tenant is $15.50 per square foot annually.

Based on above information, what would be the total annual rent for the first year per square foot of rentable area?

Part I: Calculate Total Annual Rent

Base Minimum Rent = 1,800 X 12.50 = $22,500

Percentage of Sale = 650,000 X 4.5% = $29,250

(This amount is the Total of Base Minimum and Percentage Rent)

Percentage Rent = 29,250 – 22,500 = $6,750

Additional Rent = 1,800 X 15.50 = 27,900

Total Rent for the First Year = 22,500 + 6,750 + 27,900 = **$57,150**

Part II: Calculate Concessions

3 Month's Base Minimum Rent = 22,500 ÷ 12 X 3 = $5,625

Improvement Concession = $12,000

Total Concessions = 5,625 + 12,000 **= $17,625**

Part III: Calculate Rent for the First Year

Rent Payable in First Year = 57,150 **–** 17,625 = $39,525

Per Square Foot Rent = 39,525 ÷ 1,800 = **$21.96**

MiniCram

12.5 Business Valuation

Direct Capitalization Method

Value = Net Operating ÷ Income Cap Rate

Example: The annual net operating income of a business after deducting the operating expenses is $58,000. This type of business has a capitalization rate of 12.5%. What would be the estimate of value?

Value = 58,000 ÷ 12.5% = **$464,000**

Gross Profit Multiplier Method

Value = Gross Profit X Gross Profit Multiplier

► ***Note:*** *Gross Profit Multiplier is NOT a percentage.*

Example: The annual gross profit of a restaurant business is $35,500. Market research suggests a Gross Profit Multiplier of 2.5. What would be the estimate of value?

Value = 35,500 X 2.5 = **$87,750**

Weighted Average Method

Example: A small hardware store in Cram City has provided some information on its gross profit to the listing brokerage. The amounts were $122,500 for 2010; $126,200 for 2011; $132,000 for 2012 and $137,800 for 2013. The brokerage applies a weighting to these profits as follows: Year 1 – 4, Year 2 – 3, Year 3 – 2 and Year 4 – 1. The year 1 is considered the most recent year for calculations. What would be the weighted average of gross profits for these four years?

Calculate Profits based on Weightage

137,800 X 4 = $551,200

132,000 X 3 = $396,000

126,200 X 2 = $252,400

122,500 X 1 = $122,500

Add all these numbers = 1,322,100

Divide by 10 (4+3+2+1) = 1,322,100 ÷ 10 = 132,210

Weighted Average of Gross Profits = **$132,210**

Back to Table of Contents

MiniCram

AGREEMENT OF PURCHASE AND SALE - COMMERCIAL

- **_Note_: The *Agreement of Purchase and Sale – Commercial* may be provided in the exam for your reference.**
- Read the story very carefully. Read the questions and analyze property. The question may be asking you to find _critical mistakes_ only.

Offer Date: The Date on the first page and the date with Buyer's signature need not be same.

Buyer and Seller Names: Check if they are individual sole proprietors or corporations.

Purchase Price and Deposit: Match the amounts in words and figures. If counter offer, check both parties have initialled.

Deposit: Must be payable to Listing Brokerage.

Irrevocability: First time, only the word '*Buyer*' is inserted. In Counter Offer, the word '*Buyer*' must be replaced with '*Seller*'. Check initials of both parties. Irrevocable date may be extended by Seller.

Notices: Missing fax numbers or email addresses is acceptable.
Fax numbers and email addresses are not inserted in case of Multiple *Representation*.
If only one set of fax number or email address is given, the buyer may be a *Customer* of the Listing Brokerage.

Title Search: The *Requisition Date* must be well after the last date in Conditions.
Present Use must not have Zoning. Blank space in *Present Use* is acceptable.

Signatures: For Individuals, only signatures are required. The date besides buyer's signatures need not be the same date as the date on first page of the offer.

For Corporations (Inc. or Ltd.) – Name of Corporation, then Signature and then either "*Corporate Seal Affixed*" or "*I Have the Authority to Bind the Corporation.*"
All Signatures must be witnessed.

Confirmation of Acceptance: Must be before the last *Irrevocable Date* and Time on Page 1. Make sure that it is signed by correct party.

- If Seller Accepts Original Offer (*No Change in Offer*) – One of the Sellers Signs.
- If Buyers Accept the Counter Offer (*Changes in Offer)* – One of the Buyers Signs.

Information on Brokerages: Read the scenario carefully. There is only one Brokerage in case of *Multiple Representation* or in case Buyer is *Customer* of Listing Brokerage.

Acknowledgement: Must be on or Before the Irrevocable date on Page 1. Missing Addresses or missing Lawyer Information is not a mistake.

Commission Trust Agreement: Signed by Salespersons. Missing or blank space is Ok.

Schedules

Schedule A: Match the dates and Buyer/Seller Names as on Page 1.

Order of Clauses: *Pay the Balance* always appears first. But if there is *Supplementary* or Additional Deposit clause that should be first. If any handwritten clause is inserted later, then the order is not important.

Pay the Balance Clause: Must have the 6 Essential Elements-

- Who Pays (Buyer),
- Amount (Further Sum of),
- Subject to Adjustments,
- To Whom (Seller),
- When (On Completion), and
- Mode of Payment (Bank Draft, Certified Cheque, Wire Transfer, etc.).

Check the Amount of Balance.

Balance = Purchase Price – Seller Take Back (S) – Assumed Mortgage (A) – Deposits (D)

Interest Disclosure Clause: If the Trust Account of Brokerage is earning Interest, there must be a clause disclosing the Interest Rate and how much Interest would be paid subject to Deductions.

Mortgage Clauses:

- Mortgage can be First or Second. Any Mortgage can be *New* or *Assumed* or *Seller Take Back*.
- Seller Take Back mortgage can be the First Mortgage while New mortgage can be the Second.
- The Name of the Lender is not required for New First Mortgage but is required for Assumed Mortgage.
- Amortization Period is optional but the Term (*Due Date* or *Expiry Date*) must be there.
- Postponement Clause is required if the First Mortgage expires before the second.

Counter Offer:

- All changes must be initialled by both parties.
- Check if the Irrevocable date has been changed by Seller.
- Check the Amounts and Dates very carefully.
- Calculate Balance on Schedule A after considering all changes.
- Acceptance must be before Irrevocable date by Buyer (*Not by Seller*).

Back to Table of Contents

MiniCram

AGREEMENT TO LEASE - COMMERCIAL

➢ ***Note*: The *Agreement to Lease – Commercial* may be provided in the exam for your reference.**

Critical Mistakes in Offer

Read the story very carefully. Read the questions and analyze property. The question may be asking you to find critical mistakes only.

Clause 1 – Premises: Rentable Area or Usable Area. If Usable Area is given, Deposit cannot be calculated. If Rentable Area is given, always calculate the Monthly Rent first. Verify that the Deposit is first and last month rent plus HST.

Clause 2 – Use: Should be very specific i.e. Professional, Doctors, Lawyers, etc. If *Retail* is written, it is too vague or a mistake. Should be specific such as Jewellery, Clothing, etc.

Clause 3 – Term of Lease:

- Term: Should be given in Months i.e. 36 months or 60 months. If Years are mentioned, it is a critical mistake.
- Commencement/Termination: Must be mentioned. Check that dates are valid for the term.
- Renewal Term: Should always be 1 Additional Term of 36 Months/60 Months.

Clause 4 – Rental: Check the calculations: Example $24 Per Sq. Ft x 2660 = 63,840 /12 = $5,320 Per Month. Check all rents given in the term. There may be a mistake in calculations.

Clause 5 – Deposit: Who is it payable to? *Usually* it is the Listing Brokerage.

- In case of Lease Agreement – it may be in the name of Landlord i.e. Generic Holdings Inc.
- If Landlord is holding the Deposit – Does the Landlord have a Trust Account? If not, the words "*To Be Held in Trust*" should be deleted and initialled by both parties.

Initials: Initials of Landlord and Tenant should be at the bottom. Check if initials are switched or any initials are missing.

Clause 6 & 7 – Services: Make sure the check mark is in proper place.

- Gross Lease: Fixed amount of payment should be there i.e. $1,200 per month.
- Net Lease: Tenant pays Base Rent + Some specified expenses.
- Net Net Lease: Base rent + Some Additional Rent.
- Net Net Net Lease: *Carefree to Landlord*. Tenant is responsible for all Rent and Additional Rent except Landlord's Mortgage and Income Tax payments.

Clause 11 – Landlord's and Tenant's Work: There should be a separate Schedule i.e. Schedule B or Schedule C.

Clause 12 – Signage: The wording on signage may be too lengthy.

MiniCram

Signatures and Seal: Check Signatures and one the following-

- If Seal is Used: *Corporate Seal Affixed*, or
- If No Seal: "*I Have the Authority to Bind the Corporation*" or "*Authorized to Bind the Corporation*".

Dates: All Dates must be checked. If *Irrevocable Date* and Time has expired, it is a critical mistake.

Counter Offer:

- All changes must be initialled by both parties.
- Check if *Irrevocable Date* has been changed by the Landlord.
- Check the Amounts and Dates very carefully.
- Acceptance must be before *Irrevocable* by the Tenant (*Not by the Landlord*).

Back to Table of Contents

MiniCram

PART III - PRACTICE QUESTIONS

SAMPLE EXAM 1

Take a blank sheet of paper to write your answers. The Quick Answer Key is located after the last question followed by Detailed Answers.

- ***Note:*** ***A blank or completed Agreement of Purchase and Sale – Commercial and/or Agreement to Lease – Commercial may be provided in the exam. You can refer to that form to answer related questions.***

1. Considering the supply and demand forces in commercial real estate, when available office space is high, and demand is low, which of the following would be the effect on rental rates?

   A. Rates will decrease.
   B. Rates will increase.
   C. There will be no effect.
   D. It depends on negotiations for a particular building.

2. Which of the following is typically not a part of requirements in a commercial zone?

   A. Minimum front, side and rear yard requirements.
   B. The permitted use of a particular vacant land or building.
   C. The procedures for creating a commercial subdivision.
   D. The maximum coverage of a lot and height restrictions.

3. Which of the following would be viewed as a limitation of ground lease in commercial retail sector?

   A. Ground lease is beneficial to a tenant who wants to leverage existing financial resources and use the land at a lower cost as opposed to purchase of property.
   B. The landlord benefits from having a long-term tenant and avoid the cost of building the structure.
   C. The building itself becomes the security of the lease for the landlord and lease may be terminated in case of payment default by the tenant.
   D. If expansion of the building is required, the tenant may face difficulties if the landlord obstructs desired expansion.

4. With respect to infill zoning requirements, which of the following statements is not correct?

   A. Infill zones are typically found in existing inner city neighbourhoods.
   B. The purpose of infill zones is to lessen urban sprawl and encourage better utilization of municipal services.
   C. The setback requirements for multi-residential, low rise buildings may be similar to older structures.
   D. Multi-residential structures within infill zones do not permit any type of commercial use.

5. Sale of farmland may be subject to *Capital Gains Tax*. Which of the following is a correct statement in this regard?

   A. The seller of the farm must pay Capital Gains Tax whenever farmland is sold.
   B. Exemption for qualifying farmland is capped at $750,000.

C. Similar rules apply to a farmland without depreciable property or a farmland with depreciable property.
D. Sale of farmland is treated in a completely different manner than other type of improved real property for the purpose of Capital Gains Tax.

6. Which of the following statements is correct regarding floor load in industrial buildings?

A. Floor load requirements apply only to live load and dead load but not to roofs, balconies, elevated walkways or footbridges.
B. Floor load refers to live load that includes weight of the persons, equipment and stored materials.
C. Dead load refers to weight of the structure and weight of the stored materials but not the load of any persons.
D. Floor load requirements are only used for industrial and commercial structures but not for residential structures.

7. Valuation of industrial buildings involves costing estimates as well as analysis of investor returns. Which the following statements is correct in this regard?

A. The valuation process may include direct comparison approach and cost approach but not the income approach because income is seen as a future event.
B. The term hard cost includes the cost of land and excavation but not the cost of building materials and construction.
C. The term soft cost refers to the cost of project management, engineering, legal and consultation fees, along with financing charges and connection fees.
D. The overall land cost per square foot is considered for valuation and any increase in land cost due to zoning restrictions is ignored.

8. Which of the following statements is correct regarding various types of cranes used in industrial operations?

A. A bridge crane operates on a system of horizontal rails but column-free area inside the structure is not important.
B. A JIB crane has an arm attached at an angle to a rotating mast that allows for 360 degrees' movement.
C. A gantry crane is another term used for the bridge crane with the only difference that its movement is restricted to inside the building.
D. Most industrial buildings have a combination of all three types of cranes for movement of materials inside the building.

9. Which of the following statements is incorrect regarding farm quotas and marketing boards?

A. The negotiating boards negotiate the terms of produce sale including the minimum price for a specific farm produce.
B. Farm quota boards establish the maximum amount of production and marketing for each farmer.
C. Farm quota for production and marketing is automatically transferred to buyer when a farm property is sold.
D. Farm board may have the authority to establish sale price of produce but may not be authorized to set limits on production.

MiniCram

10. The *Nutrient Management Act* sets out regulations for storage, handling, transportation and handling of commercial fertilizers. It also sets out minimum distance requirements for building farm properties.

Which of the following is a correct statement in this regard?

A. The MDS I requirements must be adhered to when building a large livestock barn.
B. The MDS II requirements must be adhered to when building a facility for storage of livestock or manure.
C. The Nutrient Management Act provides exemption to farmers from obtaining a building permit for all types of farm buildings.
D. The MDS requirements are similar for storage of commercial fertilizers as well as livestock.

11. Which of the following would be a serious concern for the buyer of commercial development land?

A. The otherwise irregular shape of the land and easements are described by an up-to-date survey.
B. Even though zoning by-laws permit the intended use, some deed restriction may still prohibit that use.
C. The land development may need amendment to zoning by-law and buyers of several adjacent lands have made successful attempts.
D. The seller has obtained phase 1 *Environmental Audit* of land before listing it for sale.

12. Which of the following statements is correct with respect to development of land in rural areas?

A. It is not possible to obtain amendment to *Official Plan* or *Zoning* due to importance of agricultural operations.
B. If the developers create land lease communities with long term leases of 40 years or more, they can avoid the subdivision control provisions of the *Planning Act*.
C. Interested rural communities which oppose development of residential subdivisions may make an appeal to *Ontario Municipal Board* against the decisions of local municipality.
D. Obtaining an approval for residential subdivision in rural area is much easier and less complex than in urban areas.

13. Which of the following statements in correct regarding leverage?

A. Positive leverage refers to the fact that the overall rate of return from investment is greater than return on equity.
B. Negative leverage refers to the fact that the return on equity is higher than the overall rate of return.
C. Neutral leverage refers to a situation when there is no difference in return realized by financing as compared to a situation when no financing is involved.
D. Leverage calculations are done by dividing the purchase price by the amount of loan.

14. The user of a commercial real estate:

A. Is mainly interested in return on invested capital and considers both operations cash flow and sale proceeds cash flow.
B. Is primarily interested in visibility, access and location of the property.

MiniCram

C. Rarely focuses on features which would help in finding good tenants or future resale of the property.
D. Does not consider overall efficiency including building layout which may affect the operating costs.

15. The risk element is involved in all major investment decisions.

Which of the following statements is NOT correct in this regard?

A. Risk related to investment in real estate refers to fluctuations in income stream and vulnerability of that income to external factors.
B. Financial risk refers to increase in interest rates and purchasing power of dollar that may go down in future.
C. Building risk involves depreciation of the structure as well as unexpected calamities.
D. Market risk involves future taxation matters, overall economic activity and elimination of forecasted profits.

16. When a business is sold, and a real estate brokerage is involved, the buyer must get a list of items (fixtures or chattels) not included in the sale. What happens if the seller does not provide such a list?

A. The buyer does not get any chattels but gets only fixtures because they are fixed to the property.
B. The buyer gets only chattels but does not get any fixtures with which the seller is running the business.
C. The buyer gets only the stock and does not get any fixtures or chattels.
D. All items, whether they are fixtures or chattels, with which the seller is running the business are deemed included in the sale.

17. Your buyer client is interested to make an offer on a franchise business. After you have drafted the offer, the buyer asks you several questions regarding franchise operations. You provide the following information in response to buyer's queries:

1. We must obtain a copy of the franchise agreement because a condition in that agreement may make our offer null and void.

2. The *Confirmation of Acceptance* will finally be signed by the franchisor and not by the seller.

3. We have to demand a *Sale of Business Affidavit* from the seller before a binding agreement takes place and this is mandatory for all business sales.

4. You might incur additional operating and recurring costs because the franchisor may be charging certain fees on regular basis.

5. One definite advantage of franchise business is that you get a readymade image and also receive operating assistance from the franchisor.

Which of the above statements is/are correct?

A. Only statements 1, 4 and 5 are correct.
B. Only statements 2, 3 and 5 are correct.
C. Only statements 1, 2 and 4 are correct.
D. Only statements 3, 4 and 5 are correct.

MiniCram

18. As per REBBA 2002, when a real estate brokerage is involved in sale of a business, certain documents must be provided to the buyer before a binding agreement is signed. Which of the following is a correct statement in this regard?

A. All statements of profit and loss ever since the seller acquired the business.
B. A statement of assets and liabilities of the business for the past 12 months or ever since the seller acquired the business.
C. A statement of the list of all goods, fixtures, chattels that are excluded from the sale.
D. If no financial statements are available, the listing brokerage must prepare the Sale of Business Affidavit.

19. There are several different terms used for measurement of area in commercial leasing. Which of the following statements is correct as it applies to areas in a retail or office building?

A. The *R/U Factor* for every tenant in a commercial building is same and is based on total rentable area and total usable area.
B. The rent charged from tenants is based on the actual floor area of the tenant known as usable area.
C. When rentable area is used for rent calculations, the additional rent is not applicable.
D. A commercial tenant must be given at least 60 days' notice if the landlord wants to terminate the lease.

20. A landlord has informed the tenant that he will be required to pay certain expenses in addition to the base rent. These expenses include proportionate share of maintenance costs, operating expenses and costs incurred in repair of major structural components of the building. This type of lease is best described as:

A. Net Lease
B. Net/Net Lease
C. Triple Net Lease
D. Percentage Lease

21. According to the pre-printed wording of the standard *Agreement to Lease - Commercial* form, which of the following is a correct statement?

A. Tenants are required to pay for all services provided by the landlord.
B. The rental amounts and the deposit are subject to *Harmonized Sales Tax*.
C. Tenants may be required to pay additions charges for signage.
D. The landlord and tenant must sign a formal lease before the start of lease.

22. The standard *Agreement to Lease - Commercial* form includes an *Assignment* clause. According to this clause:

A. If the landlord gives consent for assignment of lease or sublet of premises, the tenant shall be released of all obligations of the contract.
B. The landlord reserves the right to terminate the lease when faced with an assignment request.
C. The tenant is not permitted to assign the lease without the written consent of the landlord, which may be withheld without a reason.
D. The tenant may assign the lease or sublet the premises only with the prior written consent of the landlord, which the landlord shall not withhold unreasonably.

MiniCram

23. Negotiations involved in commercial leasing may be viewed from both landlord's perspective as well as tenant's perspective. Which of the following is not a correct statement from tenant's perspective?

A. Leasing of prime location may be a better solution because ownership of prime space may be impractical.
B. Leasing may result in 100% utilization of available financial resources for business purposes.
C. Default on lease payments is as serious as default on mortgage payments.
D. Leasing may result in better credit standing for the tenant instead of buying because mortgage would be viewed as a liability.

24. Non-payment of municipal property taxes by a commercial building owner may result in sale of the property by municipality, known as *Municipal Tax Sale*. Which of the following is a correct statement in this regard?

A. Once the *Tax Arrears Certificate* is registered on property title, the owner loses the right to redeem the property by paying tax amount in arrears.
B. Most municipal tax sales are done using the *Absolute Auction* method where no minimum bid is reserved.
C. Municipalities provide the owners with a copy of *Tax Arrears Certificate* and allow them to pay the cancellation price.
D. Upon receipt of the *Cancellation Price* the registration of *Tax Arrears Certificate* automatically becomes null and void.

25. Which of the following statements is correct with respect to *Harmonized Sales Tax (HST)?*

A. HST is applicable on all real estate transactions unless a specific exemption applies.
B. Both resale homes and resale commercial buildings are exempted from HST.
C. Registrants working with buyers should insert 'Included In' in the HST clause of *Agreement of Purchase and Sale - Commercial*.
D. The sale of an apartment building with less than 50 units would not be subject to HST if 100% of the units are used as residential properties.

26. The *Ontario Brownfields Statues Law Amendment Act*:

A. Encourages identification of contaminated lands and requires the landlords to clean-up within 9 months.
B. Provides for identification, clean-up and revitalization of abandoned or contaminated lands by simplifying development process and protection against future liability.
C. Helps municipalities in making strict laws against any contamination of land in urban areas.
D. Does not provide any protection to buyers interested to redevelop abandoned or contaminated lands against future liability because of high imputed costs.

27. Buyer Smart is working with Salesperson Kim of Power Realty Inc. He is curious to know why there is a *Residency* clause in the *Agreement of Purchase and Sale - Commercial*. Which of the following would be a correct explanation of having this clause?

A. This clause makes it mandatory for all sellers to get a clearance from *Canada Revenue Agency* that HST is not payable on this sale.

MiniCram

B. This clause makes the agreement conditional upon payment of Capital Gains Tax by a non-resident seller before the completion date.
C. This clause permits the buyer's solicitor to request that the seller must provide a declaration that he is a not a non-resident.
D. This clause permits the buyer to ensure that the seller is not a non-resident and that the buyer will not be held liable for the Capital Gains Tax on sale, if any.

28. Capital cost allowance calculations for depreciable assets may involve various methods and classification. When a capital asset is sold, recapture of capital cost allowance may occur. Which of the following statements is correct in this regard?

A. The undepreciated capital cost of an asset is the capital cost of the asset, less any capital cost allowance already claimed.
B. Recapture of capital cost allowance occurs at the time of disposition of asset regardless of the acquisition cost.
C. The half year rule states that the assets purchased after July 1st qualify for only 50% of allowance.
D. All calculations for capital cost allowance follow the declining balance method.

29. An application for expansion of a legal non-conforming use may not be accepted by municipality if:

A. The intended use is completely different from the existing use.
B. The intended use will be in compliance with the existing zoning.
C. The interests of the local community are being protected.
D. The expansion will not have any major impact on local planning.

30. Real estate registrants can reduce their errors and omissions risk related to title issues by taking due care of certain matters associated with a particular property. Which of the following is not one of these?

A. Including a condition for an up-to-date survey of the property.
B. Asking the seller about any known easements or encroachments on the property and making further investigations.
C. Relying on a dated survey provided by the seller which was certified by an Ontario Land Surveyor.
D. Verifying property details using source documents instead of relying on verbal statements given by the seller.

31. Salesperson Skinny is happy that the buyer client has shown interest in the property which is being auctioned. She goes on to collect more information about this property and finds out that the parcel of land next to this property used to be a heavy medical waste recycling plant. The building was demolished when that plant closed down a year ago. This fact was well known to the people living in that area. Skinny also finds out that before the auction the property was on the market for about 8 months but did not sell due to possibility of contaminated soil, being next to medical waste recycling plant. Acting prudently, Skinny gives all the information to the buyer. The buyer asks Skinny what they could do to address the issue. Skinny provides the following information:

1. We will ask the seller to provide a report of Phase 1 of *Environmental Audit,* which involves a visual inspection of the land and testing of soil and water samples for possible contamination.

MiniCram

2. In case the soil is contaminated, we can ask the seller to have Phase 2 of *Environmental Audit* which will take care of the corrective action and the costs involved.

3. Location of nearby medical waste recycling plant has attached a stigma to the property and we must disclose it when we list one half of this parcel of land for sale.

4. If the sellers can confirm that the soil contamination has been corrected, the stigma is also removed, and we need not worry about making any disclosures to a potential buyer.

5. After the contamination has been removed it will still take a long time to sell the property and the stigma will have a negative effect on the market value.

Which of the above statements are correct?

A. Only statements 1 and 2 are correct.
B. Only statements 2 and 4 are correct.
C. Only statements 2, 3 and 5 are correct.
D. Only Statements 3 and 5 are correct.

32. The wording of *Residency* clause in the standard *Agreement of Purchase and Sale – Commercial* provides that:

A. A non-resident seller must pay Capital Gains Tax before completion of the transaction.
B. The buyer of property from a non-resident seller must get a credit within 10 days of completion of sale.
C. The seller may either provide a certificate to buyer after paying necessary capital gains tax or credit the buyer for the amount of tax.
D. The seller must provide a statutory declaration that he is not a non-resident seller.

33. Salesperson Kristen has joined Cram Realty Inc. and has received her registration certificate from RECO. She wants to get started as soon as possible by prospecting in her farming area. One of the methods of prospecting in real estate does not involve any major advertising costs. In this particular method, the seller is convinced that the salesperson is making sincere efforts to sell the property; potential buyers can see the property without having to make an appointment and the salesperson can expand his client base by meeting more prospects. This type of prospecting activity is known as:

A. Making cold and warm calls
B. Prospecting with private sellers
C. Holding an open house
D. Calling sellers of expired listings

34. *Canada's Anti-Spam Legislation (CASL)* impacts real estate registrants when they are involved in promoting their services or products. Under the Act, a *Commercial Electronic Message (CEM)* cannot be sent to anyone without prior written consent. CASL applies to most electronic methods of communication. Which of the following is considered an exception?

A. Bulk messages sent through a social media platform.
B. Writing a message on someone's Facebook wall.
C. Using bulk email to hundreds of consumers.
D. An electronic message for promoting a residential property.

35. If the lot size is 8,000 square feet and the floor area ratio in a particular zone is 3.25, what would be the maximum building size that can be built?

MiniCram

A. 2,462 Square Feet
B. 7,386 Square Feet
C. 12,308 Square Feet
D. 26,000 Square Feet

36. An investor is looking to purchase 1.8 acres of land at the cost of $335,000 per acre. If the municipal zoning by-laws permit a maximum of 40% coverage, what would be his cost of land per buildable square foot? (1 Acre = 43,560 Square Feet)

A. $7.69
B. $19.23
C. $15.38
D. $74.44

37. The purchase price of a commercial property is $1,250,000 with a new first Mortgage of $900,000. The mortgage has interest rate of 5.5%, compounded semi-annually not in advance, and the amortization period is 25 years. The monthly mortgage payment is $5,493.52. If the annual net operating income of the property is $105,800; what would be the *Overall Rate of Return* and the *Equity Return*?

A. 8.46%; 12.78%
B. 10.42%; 13.92%
C. 10.42%; 11.39%
D. 8.46%; 11.39%

38. A business in leased premises is listed for $550,000 but is ultimately sold for $540,000 after several months on the market. The financial statements of the owner show net profit of $240,000 and operating expenses of $175,000. What would be the gross profit multiplier for this business?

A. 1.50
B. 1.75
C. 2.25
D. 3.50

39. The leasehold improvements done by a tenant use the straight-line method of calculation for capital cost allowance. If a tenant has spent $24,000 on leasehold improvements and this asset qualifies for 10% CCA class, what would be the undepreciated capital cost after 2 years?

A. $22,800
B. $21,660
C. $19,602
D. $19,200

40. Cram Cookies Inc. started its bakery operations several years ago. As of January 1st, 2013, the company had equipment and furniture with undepreciated capital cost (UCC) of $28,200. On May 15th, 2013, the company purchased additional equipment for $12,600. The CCA rate for this class of equipment was 20%. How much depreciation Cram Cookies Inc. had claimed on its 2013 tax return and what was the undepreciated capital cost as of December 31, 2014?

A. $5,640; $40,800
B. $6,900; $27,120

MiniCram

C. $5,640; 28,200
D. $6,900; $33,900

Case Study – 2 Parts

The following two questions are based on interpretation of various clauses found in a typical commercial lease. Read the question and the clause carefully and answer the questions given for each.

41. Your tenant client has asked you to explain the concessions included in the landlord's standard lease agreement. These concessions are typically included in the '*Expense Stop'* clause. Which of the following statements correctly describe the purpose of such a clause in the lease?

A. The landlord wants to limit the amount that the tenant spends on leasehold improvements.
B. The landlord wants to ensure that there is a limit to the maximum amount of concessions he would give to tenant for store improvements.
C. The purpose of the Expense Stop clause is to ensure that the tenant is not permitted to remove any fixtures from the store at the end of the lease.
D. The landlord wants to ensure that the tenant spends a minimum amount on improvements so that he can maintain uniform standards for fixtures in all stores in the shopping centre.

42. A standard lease agreement includes a clause named '*Deferment of Opening'*. The clause reads as follows:

"Notwithstanding the foregoing, the tenant agrees to co-operate in everyday endeavour of Landlord to achieve an official joint opening of the Shopping Centre (the Official Opening). If the premises are ready to be opened to the public for business prior to the opening of the official opening as established by the Landlord, the Tenant shall, at the Landlord's option and request defer its opening for business until such Official Opening, in which event the Term of the Lease shall not commence until the day of such Official Opening, on which day Tenant shall open its business in the Premises to the public and the term shall commence. Landlord shall have no liability to Tenant for requiring the Tenant to delay its opening until the Official Opening"

Which of the following statements correctly describe the purpose of this clause in a commercial lease?

1. The landlord may be held liable to the tenant if the landlord fails to adhere to the official opening date.

2. The landlord wants to ensure that the tenant opens his store for business on the official opening date set by the landlord.

3. The clause releases the tenant of any liability to landlord if he does not open the business on the official opening date.

4. The lease shall commence on the date agreed even if the official opening date is deferred by the landlord.

5. The landlord wants to ensure that if the official opening date is deferred, he will not be held liable for any such delay.

MiniCram

A. Only statements 1 and 4 are correct.
B. Only statements 2 and 5 are correct.
C. Only statements 1, 3 and 4 are correct.
D. Only statements 2, 3 and 4 are correct.

Case Study - 3 Parts

Cram Realty Inc. specializes in commercial leasing and is currently working with three different tenant clients. Binny, the Broker of Record has allocated the following clients to salespersons Sarah, Skinny and Jenny.

43. Salesperson Sarah is working with the first client of the brokerage. This client has an accounting business and wants to make an offer to lease 2,140 square feet of usable space in a 3-storey office building. The total rentable area in the building is 41,200 square feet and the total usable area is 37,465 square feet. The landlord has quoted base rent of $10.50 for the first year. The annual *Common Area Maintenance (CAM)* for the building is estimated at $438,800. Based on the information provided, what would be the annual additional rent for this client over and above the base minimum rent in the first year?

A. $21,052.33
B. $22,601.88
C. $25,064.25
D. $28,432.05

44. Salesperson Skinny is working with the second client of the brokerage who has an ice cream parlour. This client is looking to lease a unit with rentable area of 2,840 square feet in a nearby shopping mall. The total rentable area in the mall is 120,000 square feet and the *Common Area Maintenance (CAM)* is estimated to be $1,650,000. The minimum rent payable for the first year is $15.50 per square foot of rentable space. The lease has a percentage rent provision that provides for percentage rent of 6% of gross sales over the base minimum. This client is expecting gross sales of $850,000 in the first year.

Based on the information provided, calculate the total of the base minimum and percentage rent per square foot of the rentable space for this client during the first year.

A. $16.85
B. $17.96
C. $18.28
D. $26.43

45. Salesperson Jenny is working with the third client of the brokerage. This client is looking at two different shopping centres. The details of available units in these centres are as follows:

<u>Eastgate Mall</u>: The available rentable area is 2,105 sq. ft. The annual base rent is $15,788. Based on sales from other similar stores, the client estimates the percentage rent would be $3,338. The additional rent is $36,838. The landlord is willing to give a rent-free period of 2 months for base rent and will also pay for $10,000 worth of tenant improvements in the first year.

MiniCram

Westgate Mall: The available rentable area is 2,155 sq. ft. The annual base rent is $13,838 and the percentage rent based on sales from other stores is estimated at $6,350. The additional rent is $31,775 in this mall. The landlord is willing to give a rent-free period of 3 months and will also pay $7,000 worth of tenant improvements in the first year.

Which of these two shopping centres would be economical for this client based on per square foot rent of the rentable area?

A. The space in Westgate Mall would be economical as the per square foot rent for the first year is $19.27 as compared to $20.59 in Eastgate Mall.
B. The space in Westgate Mall would be economical as the per square foot rent for the first year is $18.75 as compared to $20.59 in Eastgate Mall.
C. The space in Eastgate Mall would be economical as the per square foot rent for the first year is $18.75 as compared to $19.27 in Westgate Mall.
D. The space in Eastgate Mall would be economical as the per square foot rent for the first year is $21.60 as compared to $23.48 in Westgate Mall.

Case Study – 5 Parts

Salesperson Kim of Cram Realty Inc. is looking for a suitable business for her buyer client Mr. Sanders. This buyer is interested in purchasing a restaurant with a license under LLBO. Downtown area of Cram city is the preferred location.

Kim has found a few advertisements in local newspapers. One advertisement has attracted her attention. It reads as follows:

"Great opportunity to own a franchise Bar and Grill business in a busy location and high pedestrian traffic. Asking: $229,000. Net: $112,500. Fully equipped kitchen with modern appliances. Landlord must approve transfer of lease. Low franchise fees (just 3%) of net income. Fully licenses use LLBO with a seating capacity of 60 persons. List of chattels available. Big screen LCD TV and some other equipment on leased (details available). Owner will help the buyer for one month. Don't miss."

The following 5 questions are based on Kim's search for a suitable business, buyer's concerns and her offer preparation.

46. Is there anything wrong with the net income given in the advertisement?

A. No, the seller is very honestly disclosing the net income of the business.
B. Yes, the buyer would need more clarification whether the net amount is gross or net.
C. No, income seems to be reasonable since the asking price is double the income.
D. Yes, the buyer should demand a declaration from seller regarding net income.

47. Is there any problem with the words like '*fully equipped kitchen'*, leased equipment, etc.?

A. No, most restaurant businesses do not own equipment and leasing is a standard practice.
B. Yes, most restaurant owners do not care about leased equipment and there should be a condition that they are in good working order.
C. No, the leasing company has the responsibility to transfer the lease to the buyer.

D. Yes, the buyer must ask for copies of equipment lease contracts to know more about his lease obligations.

48. The seller has provided the following information about the following details about his gross profit for the last 5 years:

2011: $39,300; 2012: $35,550; 2013: 32,400; 2014: 27,280; 2015: 25,250

Salesperson Kim is trying to estimate the value of the business to check if the seller's asking price is very high. She decides to use a weighted average of gross profits for the past 5 years with a capitalization rate of 0.20. The weightage given to profits is 5 for the most recent year 2015 and decreases by 1 for previous years. Which of the following is a correct estimate of value?

A. $198,600
B. $147,655
C. $210,900
D. $252,700

49. Salesperson Kim is convinced that the seller's asking price is reasonable. She drafts an *Agreement of Purchase and Sale (Business in a Leased Premises)* on the standard form. The offer price is $210,000 with a deposit of $12,000, payable *Upon Acceptance*. The offer is signed by the buyer on August 20th and is irrevocable until August 22nd. The completion date is set for October 30th. The first pages of the agreement have been drafted without any mistakes. She has inserted the following financing clause in Schedule A of the offer:

"This offer is conditional upon the buyer, arranging at buyer's own expense, a satisfactory business loan. Unless the buyer gives notice, in writing, delivered to the seller, within 10 days of acceptance of this offer that this condition is fulfilled, this offer shall be null and void and the deposit shall be returned to the buyer in full without deduction."

Which of the following statements correctly describe problems with the drafting of the above condition?

1. The condition must be written in subsequent format to ensure its fulfillment.
2. The amount of the loan and the name of the lender are missing from the condition.
3. There is no waiver provision in the condition.
4. The word '*satisfactory'* is not permitted in financing condition.
5. The actual date of fulfillment of condition must be included.

A. Only statements 1, 2 and 4 are correct.
B. Only statement 3 is correct.
C. Only statements 1, 3 and 5 are correct.
D. Only statements 2, 3 and 4 are correct.

50. Salesperson Kim also includes the following clause to ensure that the buyer has received copies of lease and financial statements of the business from the seller:

"The Buyer acknowledges having received from the seller and having reviewed a copy of the current lease for the property, and a profit and loss statement for the business for the past 12-

MiniCram

month period. The buyer agrees that the leased equipment, as listed in Schedule B attached herewith, is not included in the purchase price and agrees to assume the lease of all such equipment."

Which of the following are possible problems with the way this clause has been drafted?

1. The clause should be written as a condition and not as an acknowledgement.
2. The wording of the clause is vague as it does not specify the past 12-month period.
3. There must be a provision that the seller provides the financial statements as a statutory declaration.
4. The clause does not include a provision to provide a statement of assets and liabilities of the business to the buyer.
5. The clause must not mention the receipt and review of a copy of the lease.

A. Only statements 1, 3 and 4 are correct.
B. Only statements 2 and 4 are correct.
C. Only statements 1, 2 and 5 are correct.
D. Only statements 3 and 5 are correct.

Back to Sample Exam 1 Detailed Answers
Back to Table of Contents

MiniCram

QUICK ANSWER KEY

SAMPLE EXAM 1

1. A	2. C	3. D	4. D	5. B
6. B	7. C	8. B	9. C	10. B
11. B	12. C	13. C	14. B	15. D
16. D	17. A	18. C	19. A	20. C
21. B	22. D	23. C	24. C	25. A
26. B	27. D	28. A	29. A	30. C
31. D	32. C	33. C	34. B	35. D
36. B	37. D	38. C	39. D	40. B
41. B	42. B	43. C	44. B	45. A
46. B	47. D	48. B	49. B	50. B

Back to Sample Exam 1 Detailed Answers
Back to Table of Contents

MiniCram

SAMPLE EXAM 2

Take a blank sheet of paper to write your answers. The Quick Answer Key is located after the last question followed by Detailed Answers.

- ***Note:* A blank or completed Agreement of Purchase and Sale – Commercial and/or Agreement to Lease – Commercial may be provided in the exam. You can refer to that form to answer related questions.**

1. Which of the following statements is correct regarding lifestyle centres?

   A. It is an upscale business centre and is very similar to an enclosed shopping centre.
   B. Lifestyle centres include entertainment facilities but do not have any business offices.
   C. They include open-air tree-lined streets, on-street parking, boutique merchandisers, entertainment facilities and pedestrian friendly streetscapes.
   D. They are much larger than regional shopping centres and involve huge initial investment for the developer

2. Which of the following statements is not correct regarding commercial building classifications?

   A. Class C buildings are at less desirable locations; are always more than 30 years old and they need renovation before being leased.
   B. Class B Buildings are identified by their fairly good location; they are older structures than Class A buildings but are well managed and maintained.
   C. Class A buildings are found in downtown core area; have prestige location and they typically attract corporate leaders, international corporations and banks.
   D. Some market analysts may further classify Class A buildings in to AA or AAA subclasses, but no standard criteria exist.

3. Which of the following statements is not correct with respect to industrial real estate?

   A. Industrial investors are typically interested to attract a long-term tenant which provides security of return on investment.
   B. Large industrial users concentrate on site requirements and may ignore characteristics of the community.
   C. A single purpose industrial building is specifically built with only one purpose and may not permit conversion of use.
   D. The availability of present and future industrial sites may be impacted by factors such as availability of capital, extension of existing services to subject site and access.

4. Which of the following statements is not correct about the concept of building core in a multi-storey office building?

   A. Centre-core designs are better suited for larger tenant-occupied buildings while the side-core design is better suited for multiple tenancies.
   B. Building core refers to the location of central component of the building which includes functional and service needs of the occupants.
   C. Centre-core designs attract tenants who prefer perimeter windows for executives and other areas for middle management.
   D. Side-core designs attract tenants whose staff mostly has similar functions and they do not need executive offices.

MiniCram

5. Which of the following statements is correct with regard to construction of industrial buildings?

A. Concrete or poured concrete construction is preferred for small and medium-sized buildings because pre-engineered steel buildings are very expensive.
B. Most industrial buildings are primarily built as general-purpose buildings and specific structural changes are easy to incorporate heavy industrial requirements.
C. Steel construction is commonly used because it provides strength as well as flexibility to the structure during high winds.
D. Industrial building designs rarely consider requirements for bay depth, clear height or clear space because most tenants look at aesthetics of the building.

6. A land development agreement is required by municipality when:

A. The owner applies for continuation of non-conforming use.
B. An application is made for rezoning of a property for development.
C. A developer wants to make an offer on vacant industrial land.
D. A commercial building owner wants extension of non-conforming use.

7. Which of the following statements is not correct with respect to ownership of commercial properties?

A. Partnerships are created under common law and there is no legal distinction between the business operation and its partners.
B. All individuals in joint venture have undivided interest in the project and are issued equal number of shares irrespective of their investment.
C. A corporation is treated as a distinct entity from its shareholders, unless personal covenant is attached.
D. A *Real Estate Investment Trust (REIT)* may only be involved in financing of real estate projects.

8. In a lease for retail unit in a shopping centre, what is the preferred method to specify tenant's unit location, size and boundaries?

A. Provide the specific municipal address of the unit along with address of the shopping centre.
B. Attach a copy of the approved plan of subdivision to the lease.
C. Attach a site plan of the shopping centre to the lease.
D. Include a survey of the site and improvements with the lease.

9. Why is the difference between rentable area and usable area so important in a retail shopping centre?

A. So that the tenants pay additional rent for parking spaces allocated to them
B. Because rent calculation is typically based on rentable area of the unit.
C. Because the tenant must know that his rent is based on the area within his specific unit.
D. Because the tenant must know he does not have to pay for common areas.

10. Which of the following statements is not correct with respect to sub-lease of a commercial retail unit?

A. The terms of the head lease between the landlord and the tenant may affect the sub-tenant.
B. The sub-tenant is typically provided specific time period to approve the head lease.

MiniCram

C. The *Commercial Tenancies Act* mandates approval of all sub-tenants by the landlord.
D. If the landlord does not approve the sub-tenant, the sub-lease agreement becomes null and void.

11. Which of the following statements is correct with respect to commercial tenancies?

A. If a commercial tenant files for bankruptcy the indemnifier may still be held liable.
B. The *Commercial Tenancies Act* requires the landlords to pay interest on security deposits.
C. Commercial lease agreements rarely have a continuous use clause because it is harmful to the landlord.
D. The *Commercial Tenancies Act* does not permit landlords to collect tax payments in advance.

12. A commercial property owner has received a tax assessment notice for the current year. If the owner seeks reconsideration of his assessment value:

A. He must file an appeal to *Ontario Municipal Board*.
B. He must file an appeal to the Assessment Review Board.
C. He may file a *Request for Reconsideration* or can directly appeal to the *Assessment Review Board.*
D. He must file an appeal to the local *Committee of Adjustment*.

13. Due diligence by the buyer for a particular real estate transaction:

A. Is applicable to vacant industrial development land but does not apply to buildings.
B. Involves investigation of only financial and legal matters, considering future liability for the buyer.
C. Focuses mainly on investigation of financial, legal, structural and environmental factors related to the property.
D. Does not include any environmental audits because Environmental Insurance protects the buyer for all future liabilities.

14. When an amendment application is submitted for a change in zoning by-law:

A. The amendment approval always includes conditions which must be fulfilled within six months.
B. A hydrogeological report is typically required as part of the application when a community or private septic system is needed.
C. Provided that the advance consultations with municipal planning department have been done, many requirements under the Planning Act are waived.
D. Once the amendment is approved, no other public agency can raise any objection to the developer's plan.

15. Salesperson Jacob of Cram Realty Inc. is drafting an offer for a multi-residential rental apartment building. This is the first time she is working on a commercial property. Which of the following statements correctly describe the similarities and differences between agreements forms used for single family residential resale and multi-residential resale?

A. There are not many differences and the form for single family residential resale can also be used for multi-residential resale.

MiniCram

B. Since tenants usually own the appliances in all multi-residential buildings, the salesperson need not list them separately in the agreement.
C. Since both properties are essentially used as residential, a standard home inspection condition would be adequate for the multi-residential building.
D. The multi-residential agreement is more likely to include confidential financial information of the seller than in a single family residential resale.

16. The buyer of a small eight-unit rental apartment building is demanding copies of all lease agreements and many other financial statements from the seller. The seller has some concerns and does not want to provide any documents unless there is a binding agreement. How should the salespersons take care of best interests of the buyer as well as the seller?

A. The buyer should be asked to provide a statutory declaration that he will not disclose seller's financial information.
B. A confidentiality clause may be included in the offer as a condition so that the buyer does not disclose seller's information to third parties.
C. The seller may be given verbal assurance by the co-operating brokerage that his information will be kept in strict confidence.
D. The buyer may be provided a written assurance by the listing brokerage that once there is a binding agreement, all financial statements would be provided.

17. Salesperson Kim is working with a buyer client who is interested to know about sale/leaseback arrangements. In response to his questions, Kim provides the following information:

1. It is beneficial to both the buyer and the seller because the buyer gets a long-term tenant and the seller can free up his equity while retaining the same location.

2. Sale/leaseback arrangements are popular in slow market when the seller is under an impression that the sale would not be a viable option and it is better to lease.

3. It is used when the seller wants to become a tenant in his own property and sells it to an investor who is looking for good investment and a reliable tenant.

4. It is used when a brokerage is hired to sell the building to an investor who then hires the same brokerage to find a long-term tenant.

5. Sale/leaseback occurs when the current owner sells the building to the existing tenant because there was a *'Tenant's First Right of Refusal'* clause in the lease.

Which of the above statements is/are correct?

A. Only statements 1 and 2 are correct.
B. Only statements 1 and 3 are correct.
C. Only statements 2, 3 and 5 are correct.
D. Only statements 1, 2 and 5 are correct.

18. Cash flow from an investment property may be derived in many ways. Which of the following is a correct statement in this regard?

A. *Operations Cash Flow* refers to cash flow received from reversion or sale of the property.
B. Both *Operations Cash Flow* and *Sale Proceeds Cash Flow* are analyzed in order to take an investment decision.

C. After tax cash flow is not important for analysis because of uncertainties involved in tax regulations.
D. Investors rarely focus on leverage analysis when deciding about investment in commercial properties.

19. Which of the following statements is/are correct regarding *Design/Build* arrangements in commercial retail and industrial real estate?

1. Developers do not take much interest in *Design/Build* options because it tends to reduce their return on investment.

2. The land owner agrees to build a structure in accordance with the requirements and specifications provided by a specific long-term tenant.

3. Since speculation is involved in these arrangements, developers rarely get involved unless a sale/leaseback agreement is also signed.

4. Commercial tenants always prefer *Design/Build* because they need not analyze of lease vs. ownership options.

5. Developers take interest in *Design/Build* activities when demand for lease space is high and availability of existing industrial space is limited.

A. Only Statements 2 and 5 are correct.
B. Only statements 1, 3 and 5 are correct.
C. Only statements 2, 3 and 4 are correct.
D. Only statements 1, 2 and 3 are correct.

20. Which of the following statements is correct regarding municipal property tax reduction for farm business operations in Ontario?

1. If the farming operation qualifies, the tax may be reduced up to 75%.

2. All farming operations qualify for at least 50% tax reduction provided they adhere to the *Farming and Food Production Protection Act*.

3. The farmer must have a valid farm business registration number in order to qualify for tax reduction.

4. The buyer must carry on the farming business and generate certain level of gross income and apply annually for tax reduction.

5. The farm business must be 100% owned by a Canadian citizen or a permanent resident.

A. Only statements 1, 3 and 5 are correct.
B. Only statements 1, 2 and 3 are correct.
C. Only statements 1, 2 and 5 are correct.
D. Only statements 1, 3 and 4 are correct.

21. Which of the following statements is correct about sale/leaseback of industrial properties?

1. Sale/leaseback is beneficial to both the buyer and the seller because the buyer gets a long-term tenant and the seller can free up his equity for investment in other projects.

MiniCram

2. In a sale/leaseback agreement, the seller always includes an '*Option to Purchase'* clause so that he can buy back the building after the lease expires.

3. Sale/leaseback agreement is typically a result of a clause known as '*Tenant's First Right of Refusal'*.

4. The seller typically sells the property to an investor and becomes a long-term tenant of the property in order to retain the location for his business.

5. Sale/leaseback agreements are popular when the building is in poor condition and the seller would not find a suitable buyer.

A. Only statements 1, 2 and 5 are correct.
B. Only statements 2, 3, and 4 are correct.
C. Only statements 1, 3, and 4 are correct.
D. Only statements 1 and 4 are correct.

22. Which of the following statements is correct regarding advantages of investment in commercial real estate?

A. Commercial properties always have lower taxes than residential properties.
B. Lower initial investment is required as compared to a residential property.
C. There is an opportunity for growth of invested capital through refinancing.
D. Commercial investment properties provide fast liquidation of investment.

23. Salesperson Sarah of Cram Realty Inc. is working with a buyer client interested in purchasing a business. The buyer is curious to know more about franchise businesses. Salesperson Sarah provides the following information in response to buyer's questions:

1. The costs and on-going franchise fees are not significant.

2. The franchisor usually provides training which includes business techniques, marketing and financial record keeping.

3. If the value of the franchise increases over the years, the value of the business may also increase.

4. The cost of buying products would be less expensive because the franchisor has the group purchasing power.

5. You may later sell the business anytime without the consent of the franchisor.

The information provided by the salesperson is not entirely correct. Which of the above statements are correct?

A. Only statements 2 and 3 are correct.
B. Only statements 2, 3 and 5 are correct.
C. Only statements 1, 2 and 4 are correct.
D. Only statements 2, 3 and 4 are correct.

24. The *Commercial Tenancies Act* provides many rights to the landlords which are typically not found in the *Residential Tenancies Act*. Which of the following is not a correct statement in this regard?

MiniCram

A. Upon default of rent payment, the landlord may change the locks 15 days after rent became due.
B. The tenant may withhold rent payments if the landlord fails to fulfill obligations under the lease contract.
C. In certain cases, the landlord may seize and dispose of tenant's property for non-payment of rent.
D. Both the landlord and the tenant may approach the Superior Court of Justice in case of a dispute.

25. The *Commercial Tenancies Act* has certain provisions regarding termination of a commercial lease. Accordingly, which of the following statements is correct?

A. The landlord may terminate the lease anytime by giving a 30 days' notice to the tenant.
B. The tenant has no right to occupy the premises when the lease expires, and it is not renewed.
C. Once the possession of the premises is given, the landlord must wait until the end of lease to give termination notice.
D. If the tenant continues to occupy the premises after expiry of the lease, he is liable to pay two month's rent as additional security deposit.

26. The *Agreement to Lease - Commercial* form is typically used for preparing lease offers. Which of the following statements is correct in this regard?

A. The pre-printed wording of this form states that the landlord and the tenant must execute a formal lease before possession; otherwise the agreement becomes null and void.
B. The fundamental, material aspects of the lease in this form are included in the final lease and the landlord is not permitted to add any more clauses in lease.
C. This form itself may constitute the final lease between the landlord and the tenant if a formal lease is not to be drawn by the landlord.
D. This agreement does not have to be in compliance with the *Commercial Tenancies Act* so long as the formal lease is in compliance.

27. The gain realized from sale of a commercial property may be treated as capital gain or as normal business income. The *Tax Court of Canada* considers several factors when making a decision in this regard. Which of the following is not one of these factors?

A. The amount of income being reported on the income tax return.
B. The frequency of similar transactions completed by the taxpayer.
C. Taxpayer's intention before, during and after the taxation period.
D. The relationship of the transaction to taxpayer's normal business.

28. The purpose of *Ontario Brownfields Statute Law Amendment Act* is:

A. To encourage clean-up and revitalization of abandoned or contaminated lands.
B. To ensure that every industrial land buyer completes a *Record of Site Conditions* report.
C. To ensure that buyers of abandoned or contaminated land do not have to comply with the *Environmental Protection Act*.
D. To encourage the municipalities to more strictly enforce the requirements of Planning Act for redevelopment of abandoned or contaminated lands.

29. An individual who is unable to pay off his debt may have certain options under the *Bankruptcy and Insolvency Act*. Which of the following is not one of them?

MiniCram

A. The individual may meet a *Trustee in Bankruptcy* and make an attempt to avoid bankruptcy.
B. A *Trustee in Bankruptcy* may file a proposal to creditors for settlement of debt.
C. If the debtor files for bankruptcy for the first time, he may be discharged after 9 months, subject to certain qualifications.
D. An alternative to bankruptcy for an individual is to file for receivership and in that case, the receiver makes an attempt to settle the debt.

30. Jacky is looking for a real estate brokerage after completing her educational requirements for obtaining a real estate salesperson license. She understands that when employed by a brokerage, she could work as an *employee* or as *independent contractor*. Which of the following statements is not correct regarding the difference between independent contractor and an employee?

A. As an independent contractor, the brokerage could require that all advertising be approved in advance.
B. As an independent contractor, the brokerage may require her to obtain and maintain HST registration.
C. As an employee, she can always alter commission terms without authorization from the brokerage.
D. As an employee, her employment can be terminated without notice, subject to the provisions of the *Employment Standards Act* of Ontario.

31. The *National Do Not Call List* provisions for making calls apply to real estate brokerages but there are certain exceptions. Which of the following is not one of them?

A. When a party specifically requests a registrant to contact him.
B. When a party has made an enquiry about a property listed by the brokerage.
C. When a party had a listing agreement with the brokerage that expired two years ago.
D. When a party is contacted through email or other means of correspondence.

32. If the lot size is 4,800 square feet and the total floor area is 12,480 square feet, what would be the floor area ratio?

A. 2.6
B. 3.8
C. 1.3
D. 0.38

33. Investor Bright is analyzing a *Design/Build* option for his client based on his return on investment in the project. The selected parcel of land is 3.5 acres is size and is listed at $275,000 per acre. The zoning by-laws permit a maximum coverage of 35% of the total lot size. The different building costs are as follows: Soft cost - $14.55 per square foot; hard cost - $43.95 per square foot and; development cost - $12.75. If the tenant client is ready to pay annual rent of $11.50 per square foot, what would be Bright's return on investment? Assume that the *Base Rent* represents the *Net Operating Income* of the property and all operational costs are to be borne by the tenant by way of *Additional Rent*. (1 Acre = 43,560 Square Feet)

A. 8.05%
B. 9.65%
C. 12.88%
D. 14.57%

MiniCram

34. Investor Mehra is considering purchase of an apartment building having 76 units. The building is listed for $6,500,000 and Bright is ready to pay this price provided it meets his investment objectives. Bright has 35% equity available and will arrange a mortgage loan for the balance of the purchase price. The mortgage will be interest only with an annual interest rate of 6.5% per annum, with interest payment at the end of each year. The financial statements given by the seller provide the following information:

- The annual potential rental income is $1,150,000.
- The vacancy and bad debt loss is 4.5% of annual potential income.
- Other income from parking and laundry is $29,800.
- The annual operating expenses are 58.5% of the annual operating expenses.

Based on above information, what would be the Return on Equity from this purchase?

A. 8.51%
B. 9.72%
C. 10.05%
D. 12.65%

35. A small hardware store in Cram City has provided some information on its gross profit to the listing brokerage. The amounts were $122,500 for 2010; $126,200 for 2011; $132,000 for 2012 and $137,800 for 2013. The brokerage applies a weighting to these profits as follows:

Year 1 – 4; Year 2 – 3; Year 3 – 2 and Year 4 – 1.

If the year 1 is considered the most recent year for calculations, what would be the weighted average of gross profits for these four years?

A. $132,210
B. $143,278
C. $126,560
D. $129,625

36. The annual base minimum rent for a retail unit is $16.50 per square foot. The percentage rent clause specifies 5.5% of gross annual sale over the base minimum. A tenant leases a unit in this shopping centre with rentable area of 2,650 square feet. The gross annual sale for the first year is expected to be $640,000. What would be the base sale and the total of base minimum and percentage rent per square foot respectively?

A. $640,000; $16.50
B. $795,000; $16.50
C. $795,000; $21.58
D. $352,200; $23.95

37. The Cram City Centre shopping mall has 240,000 square feet of total rentable space, leased to various tenants. Cram Cookies Inc. has a store in this mall with 2,300 square feet of rentable area. There is also a beer store in the mall which is occupying 4,500 square feet of rentable space. The Beer Store has tax-exempt status and does not pay property tax to the landlord. With this situation in mind, the landlord had changed the method for property tax calculation for other tenants. If the total property tax for the shopping centre for the current year is $276,000, what would be the proportionate share of taxes for Cram Cookies Inc.?

A. $1,322.35
B. $2,460.50
C. $2,695.54
D. $2,980.73

38. The rentable area leased by a retail tenant is 1,800 square feet with a base minimum rent of $12.50 per square foot per annum. The percentage rent is $6,750. The landlord is willing to give $12,000 concession for tenant improvements in the leased unit and is also offering 3 month rent free period for base minimum rent only. The additional rent payable by the tenant is $15.50 per square foot annually. Based on this information, what would be the rent for the first year per square foot of rentable area?

A. $21.96
B. $31.75
C. $25.08
D. $34.92

39. A commercial property was purchased in September 2012 for $1,640,000. The improvement allocation at the time of purchase was $980,000. The CCA rate for the building and improvements is 4%. What would be the Undepreciated Capital Cost at the end of 2 years of ownership?

A. $960,400
B. $903,168
C. $921,984
D. $1,511,424

40. Investor Ingrid purchases a commercial building five years ago for $2,440,000 with improvement allocation of 65%. The CCA rate for this type of building was 4%. During all these years a total of $265,877 has been claimed as CCA. She did not make any major capital improvements during the years of ownership. Ingrid sells the property now for 2,980,000 with improvement allocation of 60%.

What would be the Recapture of CCA on this sale of the property?

A. $265,877
B. $270,000
C. $148,938
D. $97,600

Case Study - 2 Parts

This case study is based on your interpretation of clauses commonly found in commercial lease agreements. Your tenant client wants you to explain him the certain clauses.

41. The landlord has included the following clause in his formal lease agreement under the heading '*OVERHOLDING'*:

"If the tenant continues to occupy the premises after the expiration of the term, without any further written agreement, Tenant shall be a monthly tenant at a monthly Minimum Rental equal to one-sixth of the highest annual combined Minimum Rental and Percentage Rental that were payable by tenant during any Rental Year of the term and otherwise on the terms and

MiniCram

conditions herein set out with such changes as are appropriate to a monthly tenancy. This provision is not to affect tenant's obligation to deliver up vacant possession at the expiration of the term."

Which of the following statements is correct with respect to the wording of the above said clause?

A. The purpose of this clause is to convert the tenancy into a month-to-month tenancy after the expiry with new rent obligations.
B. The purpose of this clause is to provide the terms for the renewal of the lease.
C. The calculation of rent after expiry of the term will be based on the combined minimum rent and percentage rent paid during the final year of the lease.
D. The clause releases the tenant from delivering vacant possession of the unit after expiry.

42. Another clause is included in the lease under the heading '*NO ENCUMBERANCES'*:

"Tenant shall not sell, transfer, assign, pledge, mortgage or in any way encumber any or all of its fixtures or equipment used in the operation of its business on the premises without the prior written approval of Landlord, but this shall not prevent Tenant, to the extent usual and reasonable in the conduct of business, from leasing or creating conditional sales contracts or mortgages to secure part of the purchase price of Tenant's removable trade fixtures or furnishings or creating security upon its stock-in-trade, provided that the foregoing shall in no way prejudice or affect the priority of Landlord's rights or the obligations of Tenant with respect to such fixtures or furnishings of stock-in-trade under all other terms of this lease and with respect to the Personal Property Security Act and all laws relating to bankruptcy. Tenant shall not mortgage or otherwise encumber its interest in this lease or sublease thereof."

How would you explain the wording of this clause to your client?

A. The landlord is agreeing to allow the tenant to pledge the value of the lease as security for any future financing that may be required by the tenant.
B. In the event of default on rent payments by the tenant, the landlord wants to make sure that any fixtures or equipment seized by the landlord are not subject to a prior claim.
C. Under the wording of this clause, the tenant must obtain the written approval of the landlord to purchase any fixtures or equipment.
D. This clause effectively transfers ownership of all fixtures and equipment on the premises to the landlord.

Case Study - 3 Parts

Broker/Owner Binny of Cram Realty Inc. is providing training to his salespeople. The topic being discussed is sale of business. After a brief explanation of different complexities involved and regulatory requirements, he wants to see if his salespeople understand. Answer the following three questions.

43. Binny asks the first salesperson if he understands how businesses are evaluated. Also, what different options are available to the buyer for financing the purchase?

Select the correct statement out of the following options.

MiniCram

A. Since businesses have a steady income stream, it is easier for the buyer to get financing as compared to residential property.
B. A high capitalization rate results in a high value for the business.
C. If asset valuation is used, the assets might include the value of goodwill and a lower than market rent for the premises.
D. The *Earnout* method of financing is preferred by seller of a business because the final purchase price is established before the buyer takes possession and seller is assured of regular payments after closing.

44. A second salesperson was asked to explain the requirements of REBBA 2002 for selling a business. The salesperson gave the following answer:

"The Act requires the buyer to receive a profit and loss statement for the preceding 12 months, a statement of assets and liabilities and a list of items included in the transaction. If the buyer does not receive the financial statements, the seller must provide the buyer with a statement under oath which must include all liabilities of the business and the details of any subletting, and the buyer can waive receipt of the financial statements."

How would you judge the given answer?

A. Excellent. The salesperson gave a full and complete answer to the question.
B. Good. The salesperson's answer was a little brief and should have included the fact that the buyer's waiver must be in writing.
C. Unacceptable. The salesperson is completely confused with respect to the requirements of financial statements.
D. Unacceptable. The answer should have stated the requirement for a statement of fixtures, goods, chattels, assets and rights relating to and connected with the business that are not included in the transaction.

45. Binny then states it would be a good idea to review other related documentation which should be demanded from the seller in order to protect the buyer's interests. In response to Binny's question, a third salesperson provides the following statements:

"The requirements of the REBBA 2002 are only minimum requirements. If possible, the buyer should be provided with at least 3 years financial statements of the business. If the business is a franchise business, then the buyer must study the franchise agreement thoroughly before entering into a binding agreement. This is because the franchisor may have reserved the right to make the sale void if the franchise fee is not paid again by the buyer. The franchise fee paid to a franchisor depends on its market penetration."

The salesperson has made an error with respect to documentation. Which of the following statements best describes this error?

A. The one-time franchise fee is already paid by the seller and the franchisor cannot make the sale void if the buyer does not pay it again.
B. The salesperson incorrectly stated that REBBA 2002 requirements are minimum.
C. The buyer should get at least 5 years financial statements from the seller.
D. If the business is a franchise business, the buyer need not worry about franchise documentation because it is normally in favour of the business owner.

MiniCram

Case Study - 5 Parts

Salesperson Jacob of Cram Realty Inc. is drafting an offer for his buyer named Bright. The subject property is a retail unit number 5 in a corner plaza at 350 Cram Square. The unit is listed by salesperson Kim of his own brokerage for $384,900. Bright is ready to make an offer for $370,000 and wants the seller to finance $120,000 out of the purchase price. The listing salesperson Kim informs Jacob that the seller also wants the buyer to assume an existing mortgage in the amount of $150,000 in order save on penalty for early discharge. While the buyer agrees to assume the seller's existing mortgage, the seller also agrees to a seller take back mortgage to help the buyer. The buyer makes it clear to Jacob that he does not want to be responsible for HST on this purchase.

Salesperson Jacob prepares the offer using standard *Agreement of Purchase and Sale – Commercial* with all the terms. The buyer signs the offer on August 1, 2014 at 9.30 am.

- The offer date is August 1, 2014 with an Irrevocable date of August 3, 2014 at 10.00 pm.
- The Deposit amount is $25,000 to be submitted Upon Acceptance.
- The date set for fulfillment of conditions is set for August 12, 2014.
- The Requisition Date is September 5, 2014.
- The Completion Date is set for September 30, 2014.

The agreement contains the standard Building Inspection condition, a *Mortgage Assumption* clause and a *Seller Take Back* clause in the Schedule A as shown below:

"The buyer agrees to assume seller's existing first charge/mortgage held by Cram Financials Inc. for approximately one hundred and fifty thousand dollars ($150,000.00) bearing yearly interest rate of 5.5%, calculated semi-annually, not in advance, repayable in blended monthly payments of nine hundred fifteen dollars and fifty-nine cents ($915.59), including both principal and interest, and due on December 20, 2016. Unless the buyer gives notice in writing delivered to the seller not later than 6.00pm on August 12, 2014 that this condition is fulfilled, this offer shall be null and void and the deposit shall be returned to the buyer in full without deduction. The buyer agrees to proceed diligently to make an application to the lender and provide such documentation as required by the chargee/mortgagee for approval of the buyer as charger/mortgagor."

"*The seller agrees to take back a second charge/mortgage in the amount of fifty thousand dollars ($120,000.00) bearing interest at the rate of 8% per annum, calculated semi-annually not in advance, repayable in blended monthly payments of about nine hundred fifteen dollars and eighty-six cents ($915.86) based on a 25-year amortization and to run for a term of five years from the date of completion of this transaction.*"

46. How would salesperson Jacob complete the HST section of the agreement in order to comply with her buyer client's instructions?

A. The clause can be left blank until the seller's solicitor provides an undertaking that the sale is not subject to HST.
B. The words '*In Addition To'* are pre-printed in the Agreement of *Purchase and Sale – Commercial* because commercial sales are subject to HST.
C. The words '*Included In'* should be inserted in the clause to protect the interests of the buyer so that if HST becomes applicable it is seller's responsibility.

MiniCram

D. The words '*In Addition to'* should be inserted in the HST clause because the salesperson knows that all sales of retail units are exempted from HST.

47. Salesperson Jacob has deliberately left the *Notices* clause blank in the agreement. Which of the following statements correctly describes why this was done?

A. The fax numbers of the listing and selling brokerages cannot be filled up because both the seller and the buyer are clients of the same brokerage, resulting in multiple representation.
B. Since the buyer has signed a *Buyer Representation Agreement* after the Listing Agreement was signed, the brokerage is not permitted to send notices by electronic means such as fax or email.
C. It is definitely a critical mistake because the space in the *Notices* clause is considered essential information and missing numbers or email addresses could lead to termination of the agreement.
D. Salesperson Jacob is treating the buyers as customers even though they have signed *Buyer Representation Agreement*, and hence, he left the *Notices* clause blank.

48. Based on the mortgage clauses given in Schedule A of the agreement, do you have any concerns with the way the *Mortgage Assumption* clause has been drafted?

A. Yes, the mortgage assumption clause does not specify the amortization period which makes it difficult to verify the payment amount.
B. Yes, the mortgage assumption clause does not include the condition for approval of buyer as chargor/mortgagor.
C. Yes, the words '*per annum'* are missing in the given clause to specify that the interest rate is annual.
D. Yes, the clause should include a waiver provision so that the buyer can waive the condition in order to make the agreement a legally binding contract.

49. Based on the mortgage clauses given in Schedule A of the agreement, do you have any concerns with the way the *Seller Take Back* mortgage clause has been drafted?

A. Yes, the clause should be a conditional clause as is the case with mortgage assumption clause.
B. Yes, it is actually the buyer who is taking back the second mortgage and not the seller.
C. Yes, the seller take back mortgage cannot have more than 20 year amortization.
D. Yes, the seller take back mortgage should have a postponement provision because the first mortgage is expiring before the second mortgage.

50. What should be the correct amount of balance due on completion?

A. $65,000
B. $75,000
C. $305,000
D. $365,000

[Back to Sample Exam 2](#) [Detailed Answers](#)

[Back to Table of Contents](#)

QUICK ANSWER KEY

SAMPLE EXAM 2

1. C	2. A	3. B	4. A	5. C
6. B	7. B	8. C	9. B	10. C
11. A	12. C	13. C	14. B	15. D
16. B	17. B	18. B	19. A	20. D
21. D	22. C	23. D	24. B	25. B
26. C	27. A	28. A	29. D	30. C
31. C	32. A	33. C	34. A	35. A
36. B	37. C	38. A	39. C	40. A
41. A	42. B	43. C	44. D	45. A
46. B	47. A	48. B	49. D	50. B

Back to Sample Exam 2 Detailed Answers
Back to Table of Contents

MiniCram

SAMPLE EXAM 3

Take a blank sheet of paper to write your answers. The Quick Answer Key is located after the last question followed by Detailed Answers.

- ***Note:* A blank or completed Agreement of Purchase and Sale – Commercial and/or Agreement to Lease – Commercial may be provided in the exam. You can refer to that form to answer related questions.**

1. From a retail demand perspective, a mix of retail tenants satisfying different consumer needs that results in consolidating different shopping trips, is known as:

A. Range.
B. Threshold
C. Clustering
D. Competition

2. One of the characteristics of a Class C office building is that:

A. It is at an average location, built with average materials and quality of construction.
B. It is located in a high tech and modern business centre.
C. It is located in a less desirable area and needs extensive renovation but is available at comparatively low rent.
D. It is located in prestige areas where rents are comparatively higher.

3. From commercial retail demand perspective, the maximum distance a consumer will travel to acquire is specific product or service is referred to as:

A. Lifestyle
B. Range
C. Threshold
D. Population Base

4. Which of the following statements is incorrect regarding categories of industrial buildings?

A. Developers typically prefer multi-use industrial buildings to attract different types of tenants.
B. General-purpose industrial buildings are very common because they offer features and facilities for a variety of alternate uses.
C. Special purpose industrial buildings offer loading docks and may have cross-docking facilities for a tenant who has specific loading requirements.
D. A single purpose building is the most popular of all industrial building types because landlord gets a single tenant with a long-term lease.

5. From the perspective of an investor of real estate:

A. The decorative features of a specific commercial property are extremely important.
B. The building must fulfill the needs for the staff and business equipment.
C. The property must have prominent visibility in the neighbourhood.
D. The return on invested capital must fulfill the overall investment objectives.

6. Which of the following statements is correct regarding valuation of a business?

A. When the gross profits vary over a period of time, a simple average of profits is the only method to arrive at an estimate of value.
B. For a business in leased premises, the discounted cash flow method is best suited for evaluation.
C. When the business has marginal earning potential but notable retained earnings, the adjusted book value method is typically utilized.
D. The direct method of capitalization is suitable only for rental apartment buildings and is not used for evaluation of businesses.

7. Which of the following statements is correct regarding lease agreements related to farm land?

A. The *crop share lease* authorizes the land owner to get 50% of the crop produce.
B. In *cash rent* lease, the tenant pays the rent only if the crop yield provides adequate returns.
C. In *flexible cash lease*, the landlord gets a fixed rent but also gets some dollar amount based on crop yield.
D. In all types of farm land leases, the landlord typically supplies farmland, retains ownership and is responsible for property taxes.

8. Which of the following statements is correct with respect to commercial lease agreements?

A. The *Statutes of Frauds* does not apply to any commercial lease which is less than 3 years.
B. The formal lease prepared by landlord's solicitor is known as a settled form of lease.
C. If a lease contains percentage rent clause, the percentage for different tenants must be the equal.
D. Landlords typically calculate percentage rent based on gross sales estimates provided by the tenants.

9. Which of the following statement describes best procedures for landlords when preparing commercial lease?

A. The landlord should keep a provision that assignment or subletting of premises is never permitted.
B. The lease should permit the tenant to assign or sublet the premises but with prior written consent of the landlord.
C. The landlord should make sure that when a request for assignment or sublet is made, the lease is automatically terminated.
D. The landlord should ensure that the tenant is provided with the right to receive rents more than what he pays to the landlord.

10. Phase 1 of the *Environmental Audit*:

A. Determines the scope of contamination and recommends remedial action.
B. Is always required for every real estate transaction if the buyer needs a mortgage loan.
C. Is exempted under the *Environmental Protection Act* if the owners obtain Environmental Insurance.
D. Determines if reasons exist to believe that the property has some form of contamination.

MiniCram

11. Which of the following is a correct statement with respect to capital cost allowance (CCA)?

A. If a capital asset is purchased during a taxation year, the taxpayer may claim 50% of its cost as CCA.
B. The half year rule or 50% rule for the year of purchase applies to most capital assets including real estate.
C. A fixed allocation of 50/50 for land and building is used when a commercial property is sold.
D. The taxpayer may choose to use the straight-line method to avoid complex CCA calculations.

12. Which of the following statements correctly describe an easement?

A. A right given by one fee simple land owner to another land owner for the purchase of crops, trees or other farm produce.
B. The right given by a fee simple land owner to another land owner for a specific purpose rather than general use.
C. An encumbrance on the title of a fee simple owner which need not be documented in land registry office or in the Agreement of Purchase and Sale.
D. It is a deed restriction contained in the deed of a fee simple property to prevent the property from being used for a specific purpose.

13. Which of the following statements is correct with respect to industrial buildings?

A. Pre-engineered industrial structures are not popular anymore due to the additional time and cost required for assembly.
B. *Live load* refers to the ability of the floor to support the weight of structural components.
C. *Clear span* in an industrial building refers to the floor area which is free of interference from support walls or columns.
D. Industrial buildings used for warehousing purposes are typically divided into small segments to facilitate storage of goods.

14. Buyers of commercial properties who would use it as a distribution centre would have specific requirements. As such, which of the following would be the focus of attention for these buyers?

A. State of the art technology, modern communication systems and treatment facilities for water contamination.
B. Population density in the area as well as proximity to affluent neighbourhoods and opportunities for leasebacks.
C. Proximity to transportation corridors, time/distance factors, freight rates to major customer locations.
D. Availability and cost of skilled labour, distance to raw materials and availability of power to support the commercial operation.

15. Multi-residential apartment buildings are a major segment of commercial real estate. Which of the following statements is correct in this regard?

A. The *Commercial Tenancies Act* applies to buildings with 5 or more units. If the apartment building has 5 units or less, the Residential Tenancies Act applies.
B. It is the responsibility of the buyer of an apartment building to send notices to tenants if the rent increase dates fall between the acceptance of offer and closing date.

MiniCram

C. Residential apartment buildings are not considered business under *Real Estate and Business Brokers Act 2002*.
D. In addition to other financial statements, the Agreement of Purchase and Sale for a rental apartment building would typically include the summary of all tenant leases.

16. Sale of a multi-residential apartment building may be impacted by many factors. Which of the following is not one of them?

A. The landlord's rights under the *Commercial Tenancies Act*.
B. The rent control provisions under the *Residential Tenancies Act*.
C. The operational, financial and legal matters involved with the property.
D. The current lease agreements with existing tenants and contracts with service or utility companies.

17. When it comes to decision making for investment in commercial properties, risk assessment and analysis is a major factor. Which of the following is a correct statement with respect to risk to an investor when making an investment decision?

A. Stability of interest rates and purchasing power of dollar are some examples of risk factors.
B. Assessment of risk involves systematic analysis of yield realized on an investment.
C. The investor can reduce his risk by including rent increase clauses in tenant leases and limiting his personal obligation when borrowing.
D. When the risk is higher, chances are that the rate of return to the investor will also increase.

18. Which of the following statements is correct when a buyer is considering purchase of a business in leased premises?

A. Because a business operation provides a consistent income stream, it is easier to finance than a residential property.
B. The terms of the lease and its remaining period along with renewal privileges are some of the key factors for buyers.
C. If the seller is financing the purchase of the business, the *Earnout* method would be the best option because the sale price is established in the agreement.
D. REBBA 2002 requirements are applicable when selling a business, whether it is a private sale, or a real estate brokerage is involved.

19. The topic of assignment or subletting in a commercial lease is included in the *Common Law of Contract*.

Accordingly, which of the following statements is correct?

A. Commercial landlords ensure that the lease contains a provision for prior consent of the landlord for assignment and subletting.
B. Assignment is generally preferred by landlords over subletting because both the original tenant as well as the assignee remains liable to the landlord.
C. The *Contract Law* does not permit the landlord to prevent the tenant from assignment or subletting.
D. The landlord may include a consent requirement for subletting, but the *Contract Law* does not permit this for assignment.

20. The definition of the term *'Gross Sales'* may be specific for a particular tenant and, as such, a commercial lease typically has a section where *Gross Sales* is defined. The reason why landlord wants to know a tenant's *Gross Sales* is that:

A. It is required to calculate the base minimum rent.
B. The gross rent for the unit is based on gross sales.
C. It is required to calculate the additional rent.
D. The percentage rent is based on gross sales.

21. Rent free period are common in commercial leases and may prove to be a desirable incentive for a tenant. Which of the following is a correct statement in this regard?

A. Rent free period are typically given by landlords when there is a strong demand for commercial space.
B. Rent free period typically means that the tenant will not pay any base rent but may still have to pay the additional rent.
C. Rent free period is given at the end of the lease with a condition that the tenant has not defaulted anytime during the entire lease.
D. The *Commercial Tenancies Act* requires all commercial landlords to give three months' rent-free period to first time tenants.

22. Commercial buildings for lease may have both rentable and usable areas. Which of the following is a correct statement in this regard?

A. Usable area comprises of actual area of tenant's unit plus the tenant's proportionate share of common expenses.
B. Rentable area refers to actual usable area of tenant's unit plus the tenant's proportionate share of common elements.
C. Usable area includes all areas in the building that the tenant and its clients would be using.
D. Rentable area for a tenant is synonymous with gross floor area of all units

23. The *Ontario Brownfields Statue Law Amendment Act* has several provisions for municipalities. Which of the following statements is correct in this regard?

A. To encourage cleanup, utilization and redevelopment of abandoned or contaminated lands.
B. The discourage municipalities from redeveloping abandoned and contaminated land by making the process complicated.
C. To make the municipalities, developers and lenders accountable if they get involved in giving permission, developing or financing contaminated land by way of increasing their future legal and financial liability.
D. Provide financial relief to municipalities by decreasing their assessment base by way of reducing the ability of developers and lenders in buying and financing contaminated lands.

24. Municipalities may take possession of a property for unpaid tax arrears. Such property may be sold for recovery of taxes owing. Which of the following statements is correct with respect to these municipal tax sales?

A. Once the cancellation price has been established and included in the *Tax Arrears Certificate,* the municipality cannot sell the property for more value.

MiniCram

B. The municipality must notify mortgagee, if any, and the mortgagee may then prevent the sale by paying the cancellation price.
C. The municipal tax sale is invalid if a registered real estate brokerage is not hired for sale.
D. Even if one year's taxes are in arrears, the municipality can go ahead with sale of the property to recover unpaid taxes.

25. Changes to zoning by-laws may affect the conformity status of commercial properties. Which of the following statements is correct in this regard?

A. If the use of the property was changed after passing the zoning by-law, a non-conforming use would still be legal.
B. Non-conformity of uses frequently occurs in commercial areas only but not in residential.
C. Municipal permission is required if a legal non-conforming use building needs to be modified or enlarged.
D. The legal non-conforming use does not bind to land and if the property is sold, the use becomes illegal.

26. Real estate registrants must be proactive with environmental issues related to a parcel of land. Awareness of clues which indicate possibility of contamination can greatly reduce their errors and omissions risk. Which of the following statements is correct in this regard?

A. It is easy to identify contamination of land because the main cause is the above ground storage containers.
B. A property that does not have any visual clues may still be contaminated due to underground flow of from an adjacent site.
C. Owners of contaminated lands have limited liability which does not extend beyond the actual boundaries of their land.
D. Registrants need not pay much attention to contamination because a majority of such land has already been identified.

27. Just one month after getting her salesperson registration, Sandy lists a grocery store and proudly advertises the features of the business in a local newspaper. A buyer calls Sandy for a showing and, after much negotiations, the business is sold. After closing, the buyer calls Sandy to complain that the sellers had removed the freezer, although it was not a fixture. The freezer actually belonged to the supplier of dairy products. Sandy tells the buyer that this was the first time she sold a business and she did not know about complexities involved.

Has Sandy breached any of her obligations by her conduct?

A. Yes, Sandy has an obligation of providing competent and conscientious service to her clients.
B. No, the buyer should have known that such items are generally owned by suppliers and not the sellers.
C. No, Sandy should has shown average diligence and the buyers should be aware of her limited duties.
D. Yes, Sandy should have included the freezer in the agreement irrespective of the fact that it not owned by the seller.

28. Read the statement given below:

"This type of investment arrangement has a general partner who has unlimited liability and operates the commercial property. Other partners are only passive investors whose liability is

MiniCram

limited to the amount they invest and profits they share. These passive investors do not actively participate in the operation of the commercial property."

This type of arrangement between two or more investors is knows as:

A. Limited Partnership
B. Partnership
C. Corporation
D. Investment Trust

29. Real estate registrants may sign confidentiality agreements with buyers and sellers of commercial properties. Which of the following is would not be typically included in this agreement?

A. The brokerage or its employees shall not disclose client's information to any third party.
B. The brokerage shall return all documents on demand or when the transaction is completed.
C. The brokerage or its employees shall use the confidential information only for the intended purpose.
D. The brokerage shall be held liable if any information generally known in the commercial trading market is disclosed.

30. The standard *Agreement of Purchase and Sale - Commercial* contains a *'Residency'* clause. According to the pre-printed wording of this clause, which of the following is correct?

A. The seller of a commercial property must give a statutory declaration that he is a non-resident.
B. A non-resident seller must pay the *Capital Gains Tax* in advance and deliver a certificate to the buyer.
C. If the non-resident seller gives certificate of payment to the buyer, then the buyer shall not claim such amount as credit.
D. A non-resident seller must give credit to the buyer to satisfy buyer's liability of seller's *Capital Gains Tax*.

31. Which of the following is a correct statement regarding a salesperson working as independent contractor with a brokerage?

A. The brokerage is not responsible for the conduct of the salesperson while trading in real estate.
B. The brokerage is not obligated to provide any training, mentoring or coaching to the salesperson.
C. The salesperson must pay a monthly desk fee in order to be employed by the brokerage.
D. The brokerage is not responsible for taxation matters related to salesperson's income or expenses.

32. Which of the following statements is/are correct regarding a career in commercial real estate?

A. Planning in advance is not much effective when handling queries for a listed commercial property because every property is unique.
B. Telemarketing activities may fall under certain federal statues and are equally applicable to both residential and commercial trading activities.

MiniCram

C. When listing a commercial property for sale the registrant can ignore the contracts of the seller with utility and management companies because buyers are typically not interested.
D. The registrant should focus on larger commercial projects in the beginning to gain as much knowledge as possible.

33. If the floor area ratio for a typical industrial zone is 2.5 and a lot has gross area of 3,600 square feet, what would be the maximum building size permitted on the lot?

A. 1,440 Square Feet
B. 2,400 Square Feet
C. 6,300 Square Feet
D. 9,000 Square Feet

34. Investor Jim is analyzing a *Design/Build* option for his tenant client based on his return on investment in building costs. The selected parcel of land is 5 acres is size listed at $245,000 per acre. The zoning by-laws permit a maximum coverage of 40% of the total lot size. The soft cost is $10.50 per square foot; hard cost is $37.95 per square foot while the development cost per square foot is $12. If the tenant client is ready to pay annual rent of $9.50 per square foot, what would be Jim's return on investment? (1 Acre = 43,560 Square Feet)

A. 10.36%
B. 11.52%
C. 12.75%
D. 14.20%

35. The following financial information is available from the owner of a business:

- Gross Annual Sales are $680,000
- Cost of Goods are $402,460
- Operating Expenses are 32.25% of Gross Margin

Based on the above information, what would be the estimated value of the business based on a capitalization rate of 20%?

A. $940,166.75 rounded to $940,000
B. $1,234,980 rounded to 1,235,000
C. $1,470,565.79 rounded to $1,471,000
D. $1,804,236.21 rounded to $1,804,000

36. A commercial building has 128,000 square feet of total rentable area and 110,500 square feet of total usable area. If a tenant in this building has 1,970 square feet of usable area, what would be his rentable area rounded to nearest square foot?

A. 2,147 Square Feet
B. 2,282 Square Feet
C. 2,410 Square Feet
D. 1,701 Square Feet

37. A tenant leases a retail unit in a shopping centre that has 78,000 square feet of total rentable area and 68,870 square feet of total usable area. The tenant's usable area is 2,350

square feet. The annual operating expenses for this shopping centre are estimated to be $856,700. What would be the tenant's annual additional rent?

A. $18,905.02
B. $21,983.48
C. $23,900.30
D. $29,232.54

38. The base minimum rent for a retail unit is $13.50 per square foot per annum. The percentage rent clause specifies 5.5% of gross annual sale over the base minimum. A tenant leases rentable area of 2,200 square feet unit in this shopping centre. The gross annual sale for the first year is expected to be $700,000. What would be the base minimum rent, the base sale amount and the percentage rent?

A. $29,700; $540,000; $8,800
B. $29,700; $478,920; $8,200
C. $29,700; $368,000; $9,450
D. $25,400; $540,000; $8,200

39. A commercial building was purchased for $450,000 approximately 18 years ago. Over all these years, the owners spent $120,000 on its renovation. The adjusted cost base was established at $950,000. The building was sold last year for $1,350,000. The cost of sale was estimated at $64,500, which included legal expenses and realty commissions. What was the amount of Taxable Capital Gain from this sale?

A. $189,560
B. $215,500
C. $167,750
D. $335,500

40. A commercial property is purchased in April 2014 for $1,560,000. The land and building allocation of the purchase price is 40/60. The CCA rate for the building and improvements is 4%. What would be the Undepreciated Capital Cost at the end of 2 years of ownership?

A. $36,691
B. $880,589
C. $970,280
D. $936,000

Case Study - 2 Parts

This case study is based on your understanding of various clauses in commercial lease agreements.

41. A typical retail lease contains the following clause that makes reference to '*Continuous Use*' of the premises by the tenant during the term of the lease:

> *"Tenant shall, upon the commencement of the lease term and throughout the term, with adequate staff and stock of new merchandise and fixtures of first-class quality, be open for business and continuously, actively, and diligently operate and conduct its business in the whole of the premises in an up-to-date, first class, and reputable manner befitting a first-class shopping centre."*

MiniCram

Why would the landlord require that the tenant continuously uses the retail unit?

A. The landlord wants to ensure the rent is paid if the tenant moves out.
B. The landlord wants to set out the guidelines for the tenant to sub-let the premises.
C. The landlord wants to give the tenant the right to terminate the lease on one month's notice if the tenant discontinues operations.
D. The landlord does not want dark space in the mall that may result in less customer traffic.

42. Carefully analyze the wording of the following clause and answer the question in the end. This clause in a typical commercial lease is known as '*INTENT OF LEASE*'.

> *"It is the intent of the parties hereto that the rents reserved pursuant to this lease shall be absolutely net to the landlord free and clear of all payments, charges, or obligations whatsoever, excepting only taxes personal to landlord including income tax on the income and landlord's financing costs and that all costs, expenses, or outlays of any kind related to the premises shall be borne by tenant and that tenant shall, by payment of tenant's proportionate share of landlord's occupancy costs, share in the burden of all costs, expenses and outlays of any kind related to the common areas except as aforesaid."*

How would you explain the purpose and meaning of this clause to your tenant client?

1. The landlord wants the tenants to share all costs related to the operation of the mall by charging additional rent.

2. The landlord wants to ensure that the landlord's occupancy costs including his personal taxes and cost of financing are paid for jointly by all tenants.

3. The landlord wishes to transfer all costs related to operation of the mall to the tenants except his own income taxes and financing costs.

4. The clause clarifies that the tenant is responsible for a fixed net rent and a fixed amount of additional rent.

5. The tenant's payments shall be based on his proportionate share of common areas.

A. Only statements 1, 3 and 5 are correct.
B. Only statements 1, 2 and 5 are correct.
C. Only statements 2 and 4 are correct.
D. Only statements 3 and 5 are correct.

Case Study - 3 Parts

Cram City Foodmart Inc. has seen significant fluctuations in net profits over the past four years. The owner and a prospective buyer are negotiating an average profit over that period in order to establish value using a capitalization rate of 18%.

The net profits for years 1 - 4 are as follows, with year 1 being the most recent.

Year 1 - $47,619; Year 2 - $40,533; Year 3 - $31,975 and Year 4 - $26,566.

43. What would be the estimated value of the business based on a simple average of the net profits?

MiniCram

A. $148,930
B. $203,740
C. $230,470
D. $310,280

44. Assume that the prospective buyer agrees to a weighted average of profits over the four-year period, giving the greatest weighted to the latest years (i.e. 4x for year 1, 3x for year 2, 2x for year 3 and 1x for year 4). What would be the estimated value of business using a *Weighted Average* of net profits over the past four years?

A. $374,591
B. $253,360
C. $238,932
D. $223,662

45. The owners of Cram City Foodmart Inc. and the prospective buyer discuss the possibility of financing the sale, earnouts and the offered price. Which of the following statements is correct in this regard?

A. The value of the business can be based on assets only rather than using the capitalization. Assets may include the goodwill and leasehold interest when the rent is below market rent.
B. When using capitalization, if a high the capitalization rate is used, a higher value estimate would be achieved.
C. It is relatively easy to finance a business as compared to a residential property because business generates a steady income stream.
D. Most sellers prefer the earnout method of financing because the seller has a guarantee that full asking price would be realized upon closing. Moreover, subsequent payments by the buyer would ensure regular income to the seller.

Case Study - 5 Parts

Salesperson Kim or Cram Realty Inc. is working with a buyer client Smart who has signed a Buyer Representation Agreement with her brokerage. Smart is interested in purchasing a rental apartment building which has 16 units. This property is listed by salesperson Davis of the same brokerage. The asking price is $1,200,000 and the seller wants a minimum $40,000 as deposit by way of certified cheque.

Answer the following 5 questions based on this scenario.

46. Salesperson Kim is drafting an *Agreement of Purchase and Sale – Commercial* for the property. She has inserted $40,000 in the *Deposit* clause, payable *Upon Acceptance*. Smart tells Kim that he does not have the funds ready right away. He must wait until the closing date of his current property to have the funds in his bank account. This might take about 10 days before he has access to funds. Which of the following would be an appropriate method to deal with this situation?

A. Kim can insert '*As Otherwise Specified in this Agreement'* in the *Deposit* clause and insert an appropriate clause in the schedule to specify when the deposit would be paid.

B. Kim should tell buyer Smart not to worry because this listing is with her own brokerage and she would take care of delay in paying the deposit.
C. The buyer should not worry because although the Deposit clause states '*Within 24 Hours'*, delays are common in commercial transactions.
D. Kim can tell the buyer that REBBA 2002 provides 5 days to deposit the funds in bank account but even this is not enforced.

47. Kim arranges a meeting with the listing salesperson David to enquire about financial statements of the property. She knows that the buyer wants to review them before a binding contract is signed. David insists that the sellers shall provide such statements only after the offer is accepted by both parties. How should salesperson deal with this situation?

A. Kim may advise the buyer that she would look for another property where sellers provide financial statements.
B. A confidentiality clause may be inserted in the schedule to address the concerns of the sellers.
C. Kim may insert a condition stating that the agreement would be null and void if the seller does not provide financial statements before acceptance.
D. Kim can provide a *Pro Forma Statement* for the buyer to convince him that the financial situation of the property is good.

48. Buyer Smart is concerned that the completion of the transaction might take about 6 months. If there is a problem at a later date and the transaction does not close, the deposit would be stuck with the seller. He would also lose interest on the deposit amount for 6 months. How should salesperson convince the buyer with respect to the deposit amount?

1. The deposit remains in the *Real Estate Trust Aaccount* of the brokerage until completion or termination of the agreement.

2. The brokerage can provide a statutory declaration that the deposit would be returned to the buyer, regardless of the reason for non-completion of transaction.

3. A clause can be inserted in the agreement that the seller will pay interest on deposit to the buyer.

4. If the brokerage is receiving any interest on deposit, it would be credited to the buyer, unless a clause is inserted contrary to this.

5. A clause may be inserted in the agreement stating that the seller would keep only 10% of deposit as penalty if the conditions are not fulfilled.

A. Only statements 1, 2 and 5 are correct.
B. Only statements 2, 3 and 4 are correct.
C. Only statements 3 and 5 are correct.
D. Only statements 1 and 4 are correct.

49. Kim makes appropriate changes to the agreement and drafts the offer again. The details of the offer are as follows:

Buyer: Smart Jacobson; *Seller*: Cram Holdings Inc.

Offer Price: $1,130,000;

Deposit: $40,000; payable by February 28, 20xx

Completion Date: August 30, 20xx

In addition to standard clauses in the agreement, Kim has inserted a *Confidentiality* clause and the clause related to the delayed deposit to address buyer's concerns. The mortgage condition states that the buyer needs to arrange a first mortgage in the amount of $750,000 within 7 business days from the acceptance of the offer. The sellers are also prepared to take back a second mortgage in the amount of $300,000.

The offer is presented to the sellers on February 15, 20xx and is irrevocable by February 20, 20xx. The offer is countered by sellers with a purchase price of $1,160,000 and some other minor changes. Buyer smart agrees to the changes by inserting his initials.

Now that the terms of the agreement are acceptable to both parties, which party signs the *Confirmation of Acceptance*?

A. The seller because, being owner of the property, the seller has the ultimate right to sell the property.
B. The buyer signs the Confirmation of Acceptance at the time of making the offer.
C. The seller signs the Confirmation of Acceptance at the time of making the counter offer.
D. The buyer, because this is the last party to accept the terms of the counter offer.

50. What should be the correct amount in the *Balance Due Upon Completion* clause in Schedule A?

A. $70,000
B. $370,000
C. $820,000
D. $1,120,000

[Back to Sample Exam 3](#) [Detailed Answers](#)

[Back to Table of Contents](#)

MiniCram

QUICK ANSWER KEY

SAMPLE EXAM 3

1. C	2. C	3. B	4. D	5. D
6. C	7. D	8. B	9. B	10. D
11. B	12. B	13. C	14. C	15. D
16. A	17. C	18. B	19. A	20. D
21. B	22. B	23. A	24. B	25. C
26. B	27. A	28. A	29. D	30. C
31. D	32. B	33. D	34. C	35. A
36. B	37. D	38. A	39. C	40. B
41. D	42. D	43. B	44. D	45. A
46. A	47. B	48. D	49. D	50. C

Back to Sample Exam 3 Detailed Answers
Back to Table of Contents

MiniCram

SAMPLE EXAM 4

Take a blank sheet of paper to write your answers. The Quick Answer Key is located after the last question followed by Detailed Answers.

- ***Note:* A blank or completed Agreement of Purchase and Sale – Commercial and/or Agreement to Lease – Commercial may be provided in the exam. You can refer to that form to answer related questions.**

1. The term *'Net Absorption Rate'* in office buildings refers to:

   A. The ratio of new office space to total available office space at a given point of time
   B. The ratio of unleased office space to total available office space at a given point of time.
   C. The difference between the new available office space for lease and the office space leased over a given period of time.
   D. The difference between total available office space and office space leased over a period of time.

2. *'Power Centres'* in retail sector have become popular because:

   A. Power is a basic requirement for every retail business.
   B. Many big box retailers are located within the same complex.
   C. Big Box retailers are located far away and there is no competition.
   D. They are located in core downtown areas.

3. Under which of the following circumstances, the investor of commercial real estate would tolerate negative cash flow?

   A. When the negative cash flow occurs only after considering the annual debt service.
   B. When the investor believes that he can increase equity return by decreasing the positive leverage.
   C. When the investor does not finance the property but makes a cash purchase.
   D. When the investor believes that the property value would increase, and he would be able to make profit.

4. Which of the following best describes the market risk for an investor of commercial real estate?

   A. The building may suffer deterioration or structural damage.
   B. The overall investment climate may not be favourable in future.
   C. The real estate market is volatile and may suffer ups and downs.
   D. Inflation may adversely affect the purchasing power of dollar.

5. Under the *Real Estate and Business Brokers Act 2002*, when a brokerage is involved in sale of a business, certain documents must be provided to the buyer before a binding agreement takes place. Which of the following is NOT one of them?

   A. A statement of assets and liabilities of the business.
   B. A statement of profit and loss statement for the previous 12 months or ever since the seller acquired the business.
   C. A list of items not included in the sale.
   D. An affidavit by the seller with respect to various financial aspects of the business.

MiniCram

6. Which of the following statements is correct with respect to commercial tenancies?

A. The *Efficiency Factor* for a commercial building is calculated as the difference between total *Rentable Area* and the total *Usable Area*.
B. The rent-free period given to a particular tenant as concession is calculated on total annual rent.
C. The *R/U Factor* and the *Gross Up Factor* are synonymous terms.
D. The *Gross Up Factor* for a commercial space may increase rent obligations for the tenant.

7. To be effective, a commercial lease:

A. Must be prepared under the *Short Form of Leases Act*.
B. Must have a definite term specifying the start date and the expiry date.
C. Must be for a term of at least 3 years.
D. Must have a table of contents for various clauses.

8. Which of the following statements is correct with respect to commercial leasing?

A. Most commercial leases do not have any provision for privity between the landlord and the subtenant.
B. If the landlord does not approve the sub-tenant, the sub-tenant can file a complaint under the *Commercial Tenancies Act*.
C. If the sub-tenant does not approve the head lease, the sub-tenant may cancel the sub-lease.
D. The head lease is binding only on the tenant but not on a sub-tenant.

9. A commercial lease where the tenant is responsible to pay proportionate share of common expenses including property tax, but does not pay for major structural repairs is known as:

A. Net Lease
B. Double Net Lease
C. Gross Lease
D. Semi-Gross Lease

10. Which of the following statements is correct with respect to sale and lease of commercial properties?

A. The *Family Law Act* applies to residential properties but not to commercial properties.
B. Both the Agreement to Lease and the Lease are prepared by buyer brokerage.
C. The *Consumer Report* clause is included in commercial agreements but not in residential.
D. A commercial tenant is not considered a *'Consumer'* under the *Consumer Reporting Act.*

11. Disclosure of environmental hazards must be made to potential buyers of development land. Which of the following would not be a part of this disclosure?

A. Soil contamination due to underground oil tank.
B. That the land was never used.
C. Previous chemical operations on the land.
D. That the land was previously used as a dump site.

MiniCram

12. In most design/build projects the developers analyze their return on investment based on land and building costs. In this regard, it may be correct to state that:

A. The cost of land is a major factor during analysis whereas the soft costs and hard costs are paid for by the long-term tenant over a period of time.
B. Hard cost refers to the cost of materials and construction whereas the soft cost refers to the development charges of the project levied by the municipality.
C. The cost of land per buildable square foot typically increases the effective cost of acquiring development land.
D. Rentals rates prevailing in the town do not normally affect the developer's rate of return of the developer but the soft costs play a major role in investment analysis.

13. The buyer of a 16-unit rental apartment building is demanding all financial statements from the seller. The seller has all his financial records in order but has some concerns regarding giving them all to the buyer before there is a firm offer. Which of the following would be the best option for the salesperson involved in this transaction?

A. Convince the seller that the buyer has no right to obtain financial statements.
B. Inform the buyer if financial statements are to be provided, the offer must be unconditional and firm.
C. Inform the buyer that apartment buildings are typically sold without provision of financial information.
D. Include a list of selected financial statements that would be provided and include a confidentiality clause in the agreement.

14. Registrants should ensure that all registered owners names appear on the *Agreement of Purchase and Sale* and that they all sign the Agreement. Which of the following statements is correct as it relates to owners and their signatures?

A. When dealing with a corporation, in lieu of a seal, the person signing the offer should have signing authority and beside their signature, they should write '*I have the authority to bind the corporation*'.
B. When dealing with an estate, where there is more than one trustee, only one trustee's signature is required on an Agreement to make it valid and enforceable.
C. A *Power of Attorney* to sign for the owner of a property can be verbal rather than written if the person appointed as the Power of Attorney is a relative or the lawyer of the owner.
D. All persons who have any interest in a property must be shown as owners on the Agreement of Purchase and Sale.

15. Broker Binny is reviewing some financial statements given to him by the business owner who wants to sell his business. These statements run into several pages and include many sections. In which section Binny would most likely find the amounts owed by the business to other parties?

A. Capital Expenses
B. Statement of Assets and Liabilities
C. Profit and Loss Statement
D. Operating Expenses

16. A tenant has voluntarily moved out of his retail unit without informing the landlord. Most of his merchandise is also missing from the store. The landlord determines that this tenant has no intention to return and operate his business. This type of action by a tenant is known as:

MiniCram

A. Abandonment
B. Eviction
C. Termination Notice
D. Adverse Possession

17. Smart is a client of Cram Realty Inc. and is working with salesperson Hadley for leasing a unit is the Southwest Shopping Centre. Smart and Hadley are discussing the contents of the lease provided by the landlord. Carefully analyze the following statements provided by Handley:

1. Based on the wording of the lease, the landlord can include the cost of maintenance of two large pylons signs located at the entrance, based on the wording of the lease.
2. Tenant may be able to assign the lease during the term but cannot sublet all or a portion of the unit without the prior consent of the landlord.
3. In case of damage to the unit, if the tenant does not make necessary repairs, the landlord can make those repairs and charge the tenant for the cost.
4. The tenant will be required to remain open during the normal business hours of the shopping centre but certain tenants, with the approval of landlord, may stay open for late hours.
5. All tenants, including Smart are required to pay an amount of $8,000; which is to be applied towards the first and last month of the base minimum rent.

A. Only Statements 1, 2 and 5 are correct.
B. Only Statements 1, 4 and 5 are correct.
C. Only Statements 1, 2 and 4 are correct.
D. Only Statements 1, 3 and 4 are correct.

18. The legal principles under common law are very complex with respect to assignment and subletting of commercial leases. Which of the following statements is correct on this topic?

A. Landlords prefer assignment to subletting because when subletting takes place, the original tenant is no longer responsible for the lease.
B. Landlords typically ensure that detailed clauses are included in lease agreements that require consent of the landlord or termination of the lease in the event of assignment or subletting.
C. Lease clauses can require the landlord’s approval of subletting, but common law does not permit such a clause for assignment.
D. Because of the concept of privity of contract, a landlord has no control over the assignment or subletting of a commercial lease.

19. Broker Binny is having a conversation with his investor friend Smart. Smart asks certain questions regarding taxation matters. Binny makes the following statements:

“Careful analysis of financial arrangement when investing in commercial properties may result in reduction or elimination of taxes. The Income Tax Act provides allowance for capital costs on income producing properties and helps in reducing taxes payable on operations cash flow as well as sale proceeds cash flow.”

What is the main topic of discussion in the above statement?

A. Risk
B. Cash Flow
C. Tax Sheltering

MiniCram

D. Leverage

20. Smart purchased two properties in 2009 for the purpose of investment. He sold both in 2015 and made good profit on sale. In his 2015 annual tax return, he claimed the profit as *Capital Gains*. *Canada Revenue Agency* sends a letter to Smart concerning his tax return. If Smart claims that these properties were a part of his overall investment program:

A. *Canada Revenue Agency* must accept the taxpayer's claim and treat the profit as Capital Gain instead of treating it normal business income.
B. This may be treated as a valid argument for *Capital Gain*, provided the taxpayer is able to support his claim.
C. The profit from sale of investment properties is always treated as *Capital Gain* and this should not be a matter of dispute.
D. The taxpayer must go to the T*ax Court of Canada* to get an order that the gain realized is capital in nature and not a business income.

21. Due diligence documents regarding purchase of a commercial property is an important consideration for buyers. In this regard, which of the following statements is correct regarding a balance sheet?

A. Is solely based on the balance of inventory remaining when a business is sold.
B. Is the same as a profit and loss statement.
C. Includes information on assets, liabilities and equity.
D. Is only created in order to comply with REBBA 2002's requirements for the sale of a business.

22. Land contamination may render a property unsuitable for a specific purpose due to certain prior uses of the land involving pollutants that have impacted the property. Real estate registrants need to have awareness of the certain contamination clues when working with buyers of development land. Which of the following statements are correct in this regard?

1. Registrants must be aware of the fact that an abutting land and its use may have contaminated the soil and underground water of the land under consideration.
2. Registrants need to have sound knowledge of major soil and water contaminants that may impact the intended use of land by a buyer.
3. Registrants need not be concerned about contamination because '*Legal, Accounting and Environmental Advice'* clause in the agreement states that the brokerages cannot be held liable for any environmental hazards on the land.
4. Registrants must not ignore any visible clues of soil or water contamination; and if in doubt, should insert appropriate clauses in the agreement to protect the best interests of the buyer.
5. Failing to discuss environmental concerns with a buyer, while not being an expert, may help reduce the errors and omissions risk for the registrant.

A. Only statements 1 and 5 are correct.
B. Only statements 1 and 4 are correct.
C. Only statements 2, 3 and 5 are correct.
D. Only statements 3 and 4 are correct.

MiniCram

23. Jimmy has completed all the pre-registration courses successfully in order to qualify for registration as salesperson under the *Real Estate and Business Brokers Act 2002*. He has decided which brokerage to work for and whether to operate as an *independent contractor* or work as an *employee*. Which of the following statements is correct with respect to applying for the registration as salesperson?

A. Jimmy must obtain proof of sufficient auto insurance coverage and RECO *Consumer Deposit Protection Insurance* before sending application.
B. While independent contractor status may prove more expensive to Jimmy for the first two months as a salesperson, he will benefit from the personal guidance and consulting as compared to being in employee status.
C. Jimmy should send in his application to registration immediately and notify RECO after approval of registration as to which brokerage he wants to work for.
D. If considered appropriate, RECO may obtain credit information on Jimmy and may refer to a criminal search before approving the registration application.

24. New salespersons must use due diligence in conducting their real estate business. While changes of fast progress are there, certain inherent problems also exist. Which of the following is a correct statement in this regard?

A. Income from real estate trading business is unpredictable and several months may pass without any completed transaction.
B. There is a guarantee of income from sales that involve lengthy negotiations and complex paperwork.
C. Since the accountant takes care of taxation matters at the end of year, the salesperson need not worry much about timely remittances.
D. Commercial buyers rarely back off from conditional sales and the salesperson may count on commission income.

25. If the lot size is 7,200 square feet and the floor area ratio in a particular industrial zone is 1.5; what would be the maximum building size that can be built?

A. 1,765 Square feet
B. 3,529 Square feet
C. 5,400 Square feet
D. 10,800 Square feet

26. A vacant industrial lot has gross area of 75,028 square feet with a maximum of 42% coverage permitted under the zoning. The land lost is estimated at $9.84 per buildable square foot. The total of hard cost, soft cost and development cost is $72.86. The tenant for this building is offering net rent of $8.50 per square foot per annum. What would be the return on investment for the developer?

A. 9.53%
B. 10.28%
C. 11.49%
D. 13.50%

27. Investor Graham is interested to purchase a 30-unit apartment building located a 35 Cram Square. The purchase price is $2,650,000. Graham will use $1,100,000 from his own resources. He has arranged a loan for the balance amount for which the monthly payment is 7,188.50.

The sellers have provided the following information for the subject apartment building:

- Annual Potential Rental Income is $360,000
- The applicable Vacancy and Bad Debt Rate is 3.5% of Annual Potential Income.
- Additional Income from Parking and Storage spaces is $11,250
- Annual Operating Expenses are estimated as 45% of the Gross Operating Income.

Based on the above information, what is the Cash Flow Before Taxes (CFBT) from this building?

A. $86,262
B. $110,995
C. $161,393
D. $358,650

28. A restaurant business has an annual gross profit of $39,500. It is listed for sale at $109,000. The annual operating expenses estimated are at $45,800. Market research suggests a Gross Profit Multiplier of 2.5. What would be the estimate of value?

A. $114,500
B. $105,700
C. $98,750
D. $43,600

29. The following financial information is available from the owner of a business:

- Gross Annual Sales are $680,000
- Cost of Goods are $402,460
- Operating Expenses are 32.25% of Gross Annual Sales

Based on the above information, what would be the estimated value of the business based on a capitalization rate of 20%?

A. $940,16.75 rounded to $940,000
B. $1,234,980 rounded to 1,235,000
C. $1,470,565.79 rounded to $1,471,000
D. $1,804,236.21 rounded to $1,804,000

30. A tenant leases a retail unit in a shopping centre that has 140,000 square feet of rentable area and 122,000 of usable area. The tenant's usable area is 4,200 square feet. The total operating expenses for this shopping centre are estimated to be $2,226,500 annually. What would be the tenant's annual additional rent?

A. $66,795
B. $76,650
C. $88,123
D. $105,230

31. Cram City Liquidations Inc. has leased 2,200 square feet of rentable area in a local shopping centre. The minimum rent is $18.50 per square foot of rentable space. The lease has a percentage rent of 6.5% of gross sales over and above the base minimum. The gross sales in the first-year sale was $600,000 and in the second year it is estimated to be $750,000. With this

information, what would be the amount of percentage rent over the base minimum for the first and second year?

A. $6,500 and $13,075
B. $1,300 and $8,050
C. Nil and $8,050
D. $18,400 and $39,000

32. Owner Michael incorporated a business on July 15, 20xx. He purchased $24,200 worth of office equipment and furniture on August 25th of the same year. The CCA class for these items is 20%. Calculate the *Undepreciated Capital Cost (UCC)* at the end of 2 years.

A. $4,614.58
B. $9,229.16
C. $14,723.93
D. $18,458.30

33. A capital asset is purchased for $10,000 with a *Capital Cost Allowance (CCA)* at 5%. Which of the following statements is true?

A. The amount of depreciation for the first year using the 50% rule would be $2,500
B. The *Undepreciated Capital Cost (UCC)* after the second year, if all allowable depreciation was taken and using the 50% rule would be $7,500
C. The *Undepreciated Capital Cost (UCC)* after the first year using the 50% rule would be $9,750.
D. The unused *Capital Cost Allowance (CCA)* cannot be forwarded to the following year if it is not used within the allotted year.

34. Broker Binny's real estate brokerage was incorporated 2 years ago. The brokerage began its operation with existing equipment and furniture, which had an undepreciated capital cost of $48,100 as of January 1, 2016. The brokerage purchased more new equipment at a cost of $15,800 in July 2016. During the same year, the brokerage disposed of some of its used equipment worth $12,400. This used equipment had a capital cost of $11,000 and falls in a class where the CCA rate is 20%. Based on this information, calculate the CCA for the year 2016 and the undepreciated capital cost at the beginning of next year 2017.

A. $10,100; $42,800
B. $9,620; $48,400
C. $12,400; $58,600
D. $11,000; $49,100

35. Investor Brown purchased an industrial property in 1985 for $128,000. On August 15, 1999 Brown got an appraisal of the property for taxation purposes. This appraisal indicated a value estimate of $210,000. He had claimed a total of $328,400 in *Capital Cost Allowance* over the entire period of ownership. Due to deterioration of the building and increasing land costs, the property was sold in 2014 for $1,250,000. However, the value of the building at the time of sale was zero. What would be the amount of Recapture of previously claimed *Capital Cost Allowance* as a result of this sale?

A. $164,000
B. $210,000
C. $328,400
D. Zero

MiniCram

Case Study - 2 Parts

Your commercial client is studying the lease document provided by the landlord. He wants you to explain him a clause titled '*Damage to Premises'* in the lease.

►***Note****: Please refer to Chapter 8 of the text book to study the clause.*

36. How would you interpret the wording of this clause?

1. Any damage to a tenant's leased premises will result in an abatement of rent irrespective of the amount of damage.
2. The tenant will not be responsible for any rent payments during the period the premises is not available for use.
3. No abatement in rent will apply if the tenant or any of its employees are involved in causing the damage.
4. The clause limits the time frame for repair of damage to 10 days.
5. The reduction in rent will be proportional to the area which is not usable due to damage.

Which of the above statements is/are a correct interpretation of the clause?

A. Only statements 1 and 4 are correct.
B. Only statements 2 and 5 are correct.
C. Only statements 1, 4 and 5 are correct.
D. Only statements 2, 3 and 4 are correct.

37. The client is still not clear about this clause. Which of the following is NOT a correct statement in this regard?

A. This section of the lease is also known as *Damage and Destruction* clause.
B. The purpose of this section is not abatement of rent but that the unit cannot derive profits in case of damage.
C. The landlord ensures that even if there is damage to the unit or the shopping centre, the tenant keeps on paying the rent.
D. The clause ensures that the landlord makes repairs in an expedient way so that the tenant may resume its business as early as possible.

Case Study – 3 Parts

►***Note****: This case study is based on the* ***Agreement of Lease – Commercial****. We are providing sections of the Agreement for reference so that you may answer these questions. In case such a case study appears in the exam, a complete agreement would be provided.*

The Westside Factory Outlet Mall is located in Anycity is owned by 999998 Ontario Inc. Michael Petrovic, the regional manager, is authorized to sign all documents on behalf of the corporation. The listing for the lease clearly states that the lease is to be for a maximum term of 5 years with a renewal option of 3 years, upon 90 days' notice before expiry. The list price is $17 per square foot for the first 3 years and then $18 for the remaining two years. The listing brokerage is ABC Realty Inc. and the listing Salesperson is F. Lane.

Mrs. Karen Abdi, the president of *Just for Ladies Inc.* is interested in leasing a 2,000 square feet (rentable area) unit in this mall. Mrs. Abdi is ready to offer a rent of $15 for the first three years

MiniCram

and $18 for the remaining two years. Salesperson Warden of ABC Realty Inc. has prepared the *Agreement to Lease- Commercial* for his client Just for Ladies Inc.

Illustration 1

for use in the Province of Ontario

This Agreement to Lease dated this 11th day of June 20xx

TENANT (Lessee), Just for Ladies Inc.
(Full legal names of all Tenants)

LANDLORD (Lessor), 999998 Ontario Ltd. d/b/a Westside Factory Outlet Centre,
(Full legal names of all Landlords)

The Tenant hereby offers to lease from the Landlord the premises as described herein on the terms and subject to the conditions as set out in this Agreement.

1. PREMISES: The "Premises" consisting of approximately 2,000 square feet (feet/metres) (rentable) more or less on the 1st floor of the "Building" known municipally as 11381 Western Avenue, Unit 7 in the City of Anycity, Province of Ontario, as shown outlined on the plan attached as Schedule "A".

2. USE: The Premises shall be used only for retail sales

Illustration 2

3. TERM OF LEASE:
(a) The Lease shall be for a term of sixty (60) months commencing on the 1st day of August, 20 xx, and terminating on the 30th day of June, 20xx

(b) Provided the Tenant is not at any time in default of any covenants within the Lease, the Tenant shall be entitled to renew this Lease for 1 additional term(s) of 60 months (each) on written notice to the Landlord given not less than 6 months prior to the expiry of the current term at a rental rate to be negotiated. In the event the Landlord and Tenant can not agree on the fixed minimum rent at least two months prior to expiry of the current lease, the fixed minimum rent for the renewal period shall be determined by arbitration in accordance with the Arbitration Act or any successor or replacement act.

4. RENTAL: Fixed minimum rent: The fixed minimum rent payable by the Tenant for each complete twelve-month period during the lease term shall be:

From 08/20xx to 07/20xx inclusive, $ 32,000 per annum being $ 2,500 per month, based upon $ 15.00 per sq. foot (foot/metre)

From 08/20xx to 07/20xx inclusive, $ 36,000 per annum being $ 3,000 per month, based upon $ 18.00 per sq. foot (foot/metre)

From .... to .... inclusive, $ .... per annum being $ .... per month, based upon $ .... per sq. .... (foot/metre)

From .... to .... inclusive, $ .... per annum being $ .... per month, based upon $ .... per sq. .... (foot/metre)

From .... to .... inclusive, $ .... per annum being $ .... per month, based upon $ .... per sq. .... (foot/metre)

plus HST, and other tax (other than income tax) imposed on the Landlord or the Tenant with respect to rent payable by the Tenant, payable on:
(Check one box only)

☑ the 1st day of each month commencing August 1, 20xx

☐ the .... day of the first month immediately following completion of the Landlord's Work.

The fixed minimum rent shall be adjusted if the actual measurements of the Leased Premises differ from the approximate area. The actual measurement shall be agreed upon and failing agreement, calculated by an Ontario Land Surveyor/Architect using the current Building Owners And Managers Association standard form of measurement and shall be binding on both parties.

INITIALS OF TENANT(S): ◯ **INITIALS OF LANDLORD(S):** ◯

Illustration 3

5. DEPOSIT AND PREPAID RENT: The Tenant delivers .... Herewith ....
(Herewith/Upon acceptance/as otherwise described in this Agreement)
by negotiable cheque payable to .... ABC Realty Inc. .... "Deposit Holder"
in the amount of ------------------------------Five Thousand------------------------------
Canadian dollars (Can$ ..... $5,000.00 ....) to be deposited and held in trust as security for the faithful performance by the Tenant of all terms, covenants and conditions of the Agreement and after the earlier of occupancy by the tenant or execution of the Lease to be applied by the Landlord against the .... first .... and .... last .... month's rent and HST. If the Agreement is not accepted, the deposit is to be returned to the Tenant without interest or deduction. For the purposes of this Agreement, "Upon Acceptance" shall mean that the Tenant is required to deliver the deposit to the Deposit Holder within 24 hours of the acceptance of this Agreement. The parties to this Agreement hereby acknowledge that, unless otherwise provided for in this Agreement, the Deposit Holder shall place the deposit in trust in the Deposit Holder's non-interest bearing Real Estate Trust Accountand no interest shall be earned, received or paid on the deposit.

Carefully analyze the above shown parts of the offer and answer the following questions.

38. Do you see any critical mistakes on the first page of the offer?

1. Mrs. Karen Abdi's name should appear as tenant instead of Just for Ladies Inc.
2. It is not clear in the offer whether the area of 2,000 square feet is *Rentable* or *Usable*.
3. The date of commencement of the lease should be 1st of July and not 1st of August.
4. The use of the unit is vague and must be specific such as '*Clothing Store'*.
5. The term of the lease is incorrect, and it should be 1st of August to 31st of July.

A. Statements 1, 2 and 3 are correct.
B. Statements 2 and 3 are correct.
C. Statements 4 and 5 are correct.
D. Statements 1, 3 and 4 are correct.

39. Do you have any concerns with the way rent calculations have been completed?

1. The rental for the first year should be $30,000 based on $15 per square foot.
2. The rental details for each year must be spread in all five lines.
3. The monthly rent in the second line should be $3,600.
4. The details of the rental are not clear, and these should be spread in all five lines or a note be inserted specifying the rent structure.
5. The first month rent has to be deducted from the rent calculations because it is being paid with security deposit.

A. Statements 1, 2 and 3 are correct.
B. Statements 1, 3 and 5 are correct.
C. Statements 2, 3 and 5 are correct.
D. Statements 1 and 4 are correct.

40. Is there any critical mistake regarding the *Deposit* clause and the amount of deposit?

1. The deposit cannot be specified as '*Herewith'* because '*Upon Acceptance'* is the industry standard.
2. The amount of deposit is incorrect and it should be $6,215.
3. The deposit must be payable to ABC Realty Inc., which is the listing brokerage.

MiniCram

4. The deposit amount and the prepaid rent must be specified separately.
5. If the deposit is payable to the landlord, the salesperson should delete the words '*Held in Trust'* if the landlord does not have a trust account.

A. Statements 1, 3 and 4 are correct.
B. Statements 2 and 5 are correct.
C. Statements 2, 3 and 5 are correct.
D. Statements 1 and 3 are correct.

Case Study – 10 Parts

►***Important Notes***

- ***Students are advised not to memorize any of these questions.***
- ***These 10 questions are included here for general understanding of offer basics.***
- ***Typically, only 5 questions appear in the exam.***

Please refer to the Agreement of Purchase and Sale – Commercial provided in the exam.

41. Do you have any concerns with the way the *Legal Description* of the property has been provided?

A. The reference to an easement cannot be included in the legal description of the property.
B. A major hydro easement is indicated but there should be a clause with respect to an up-to-date survey of the property.
C. The legal description does not include any *Reference Plan* number.
D. Two lots i.e. Lot 8 and Part of Lot 9, cannot be sold in a single Agreement of Purchase and Sale.

42. Is there any problem with the *Deposit* or the amount of deposit?

A. No, but the deposit must be at least $92,250; which is 10% of the purchase price.
B. Yes, the deposit must be either '*Herewith'* or '*Upon Acceptance'* and it cannot be described otherwise.
C. Yes, the deposit cheque must be in the name of ABC Realty Inc.
D. No, the deposit amount is not a concern but none of the schedules includes any clause to specify when and how the deposit amount would be paid.

43. The *Information on Brokerages* section indicates that two different brokerages are involved in the transaction. But the *Notices* clause does not include any reference to fax numbers or email addresses for sending or receiving of notices. Is there any problem with this?

A. No, the *Notices* clause may be left blank if the buyers and sellers have given specific instructions for personal delivery of notices.
B. This is a mandatory section and must be completed in order to avoid legal problems.
C. The email addresses may be left blank, but the fax numbers of brokerages must be provided.

MiniCram

D. Since both the buyer and the seller are represented by brokerages, the *Notices* clause must be left blank as shown.

44. Do you have any concern with the '*Requisition Date'* within the *Title Search* clause?

A. No, the date is perfect because the buyer's lawyer must get over one month for title search.
B. No, the title search must begin right after the *Confirmation of Acceptance* has been signed.
C. Yes, the *Requisition Date* is too early and should be after the conditions have been fulfilled or waived.
D. Yes, the *Requisition Date* is a distinct date from *Title Search* date and it must be specified in a separate clause in the Schedule.

45. Do you notice any concerns with the way the *Balance Due Upon Completion* clause has been drafted?

A. Yes, there is no provision that the amount is to be held in Real Estate Trust Account of the listing brokerage.
B. No, the clause is well written, it contains all essential elements and the balance amount of $430,000 is correct.
C. Yes, the amount should be $530,000 because the *Seller Take Back* in the amount of $100,000 should not be deducted.
D. Yes, the amount should be $775,000 because the *Assumed Mortgage* in the amount of $345,000 should not be deducted.

46. The agreement includes a provision that the seller is taking back a mortgage in the amount of $100,000. Do you have any concerns with the way the *Seller Take Back* clause has been drafted?

A. Yes, the words '*Not Less Than'* should be included with the amount of the seller take back mortgage.
B. No, the clause is well written except that the amortization period has not been included and this may be a problem.
C. No, the clause the poorly written because the interest rate must be more than the interest rate of the first mortgage.
D. Yes, the seller take back clause should be written as an agreement clause and not as a conditional clause.

47. What is your assessment with respect to the clause for '*Due Diligence'* documents related to structural, fire, mechanical, surveying, appraisal, etc.?

A. The clause is poorly written because a condition precedent clause typically includes a Waiver provision.
B. As a standard practice, each document must be written in a separate clause because of the time required to inspect may be different.
C. The time period provided in the clause is more than a month and an *Escape* clause should be included in order to protect the seller's interests.
D. The clause is poorly worded because it is the seller, not the buyer, who needs to send a notice that the condition has been fulfilled.

MiniCram

48. Do you notice any concerns or problems the way Buyer's signatures are inserted?

A. Yes, the name of the person acting on behalf of the corporation should be inserted instead of the corporation name.
B. No, there is no problem with the way this section is completed but a corporate seal must be used.
C. Yes, the name of the Buyer corporation is inserted but the signature of the person acting on behalf of the corporation is missing.
D. No, there is no problem with the way this section is completed but the words '*I Have the Authority to bind the Corporation'* must be included.

49. Based on the financial details given in the *Agreement of Purchase and Sale* and the Schedules, do you see any missing clauses related to mortgage?

A. No, the clauses are well written, and no required clause is missing.
B. Yes, a postponement clause is required because the first mortgage comes due before the second mortgage.
C. No, the clauses are well written, but the *Mortgage Assumption* clause must be a conditional clause.
D. Yes, the clause for a new first mortgage is missing from the schedules because every agreement must have a clause for arranging a new first mortgage by the buyer.

50. Based on the chronology of events mentioned in the *Agreement of Purchase and Sale,* which of the following is a correct statement?

A. The exact date of completion should be mentioned in the *Balance Due on Completion* clause.
B. The *Acknowledgement* date cannot be the same date as the date of *Confirmation of Acceptance*.
C. The *Confirmation of Acceptance* cannot be signed before the *Irrevocable* date of April 16, 2017.
D. If the date on the first page of the offer is not the same date as the buyer signs the offer, then that date is considered as the offer date.

[Back to Sample Exam 4] [Detailed Answers]

[Back to Table of Contents]

MiniCram

QUICK ANSWER KEY

SAMPLE EXAM 4

1. D	2. B	3. D	4. C	5. D
6. D	7. B	8. C	9. B	10. D
11. B	12. C	13. D	14. A	15. B
16. A	17. D	18. B	19. C	20. B
21. C	22. B	23. D	24. A	25. D
26. B	27. B	28. C	29. A	30. B
31. C	32. D	33. C	34. A	35. D
36. B	37. C	38. C	39. D	40. B
41. B	42. D	43. A	44. C	45. B
46. D	47. A	48. C	49. B	50. D

[Back to Sample Exam 4]   [Detailed Answers]
[Back to Table of Contents]

MiniCram

PART IV - DETAILED ANSWERS

SAMPLE EXAM 1

1. A. When availability of commercial available space is high, and demand is low, the rental rates tend to decrease. This is a simple supply and demand rule. It is incorrect that there will be no effect on rates or that the rental rates will increase due to low demand. Also, negotiations for a particular building are unlikely to affect rental rates in the market.

2. C. The setback requirements in zoning by-laws do not specify the procedures for creation or registration of a commercial subdivision. These regulations are included the provincial *Planning Act*. Zoning by-laws typically include minimum setbacks requirements, maximum lot coverage, maximum height of buildings and permitted uses.

3. D. A restriction on ground lease arrangement is that when the tenant wants expansion of the building, the landlord may not permit the desired expansion. Other statements related to the ground lease are incorrect because they are benefits of ground lease arrangements.

4. D. The infill zoning for selected developments may permit limited commercial uses such as offices, retail or convenience stores.

Other statements regarding infill zoning are correct.

5. B. The *Income Tax Act* provides for an exemption of up to $750,000 in *Capital Gains Tax* exemption to qualifying farmland on all or a portion of capital gains, regardless of who the buyer is. It is incorrect to say that the seller of farmland must pay *Capital Gains Tax* whenever farmland is sold. This is because certain exemptions exist. Farmland without depreciable property or a farmland with depreciable property are treated differently for calculations of capital gains or for recapture of previously claimed capital cost allowance. In general sale of farmland is treated in similar manner for the purposes of capital gains tax.

6. B. *Floor load* refers to live load on a structure which includes weight of the persons who would assemble in a structure, the weight or equipment or machinery and the weight of the materials to be stored in the building.

Building structural standards in *Ontario Building Code* specify floor load for a particular building and it depends on the type of the structure and its use. It is incorrect to state that floor load does not include the dead load. *Dead load* refers to the load of the structural components only. Floor load requirements are for both residential and commercial buildings.

7. C. *Soft cost* includes project management, engineering, legal and consultation fees, along with connection fees and financing charges. The valuation process may be done using direct comparison approach, cost approach or income approach.

Hard cost includes cost of land cost, and all other structural, mechanical and electrical components. It also includes the cost of excavation, filling, landscaping, asphalt, curbs, etc. Zoning restrictions such as maximum coverage, maximum building height, etc. usually increase the land cost for the developer. The land cost per buildable square foot may be much higher than the initial land cost per square foot.

8. B. A *JIB crane* has an arm attached at an angle to a mast. The mast can rotate 360 degrees and allows for movement of materials anywhere inside the structure. A *bridge crane* operates on horizontal rails and requires column free areas. A *gantry crane* is a special type of bridge crane with the difference that it can be used both inside and outside of the building. It is incorrect that most industrial buildings have all three types of cranes because crane requirements depend on specific industrial use.

9. C. This statement is incorrect. Farm quota allocated to a particular farmer is not automatically transferred to the buyer. Registrants dealing with sale of farm property must include a condition that the sale will not become binding if the farm quota is not transferable to the buyer.

Other statements are correct about different types of farm quota and marketing boards.

10. B. The *Minimum Distance Separation (MDS)* requirements for livestock and manure storage buildings are specified in MDS II. MDS I requirements specify the minimum distance requirements for fertilizer storage facilities.

The *Nutrient Management Act* does not provide exemption to farmers from obtaining building permits for farm related structures. The MDS requirements for storage of fertilizers are different from facilities for storage of livestock and manure.

11. B. Even though zoning of an area permits a particular use of the property, a deed restriction may still prohibit that use. This may be a matter of concern for the buyer of development land.

Other statements are not a matter of concern for the buyer but may prove good for him. An up-to-date survey of the property precisely describes the shape, size, easements and encroachments on the land. If owners of adjacent lands have been successful in obtaining zoning by-law amendments, this is a good sign for the buyer. If the seller has obtained phase 1 *Environmental Audit* before listing the land for sale, this should not be a concern for the buyer.

12. C. Interested groups in rural areas that oppose development of new residential subdivisions in their areas may appeal to *Ontario Municipal Board* if the municipality decides to approve a residential subdivision.

It is incorrect that obtaining an amendment to *Official Plan* or Zoning is completely impossible. Developers cannot avoid the subdivision control provisions of the *Planning Act* in rural areas by creating a long-term land lease community. Obtaining approval for a residential subdivision in rural areas is not easier than in urban areas.

13. C. Neutral leverage (no leverage) occurs when financing of the property does not make any difference in return as compared to a situation when no financing is involved. Both situations result in similar yield to the investor.

Positive leverage means that financing the property results in higher equity yield than the overall rate of return. Negative leverage means that financing the purchase results in lower equity return than the overall rate of return. Leverage is calculated by dividing the loan amount by the value of the property (*Loan to Value Ratio – LTV*).

14. B. The user of an investment property is primarily interested in visibility, access and location of the property. They have personal interest related to utility of the building.

MiniCram

It is incorrect that users are only interested in return on investment, though that may be one of the decision-making factors. Users typically focus on features which may help in attracting tenants or in future resale of the property. Overall efficiency of the building, such as its layout, helps in lowering operating costs and this is one of the key factors considered by users.

15. D. *Market risk* with respect to commercial investment involves trends in local real estate market and occupancy rates.

Future taxation, overall economic activity and elimination of desired profits are, in fact, known as *business risk*. Other statements regarding various risks involved in investment real estate are correct.

16. D. If the buyer does not provide a list of items excluded from the sale, then all such items (fixtures, chattels, goods and other assets which are related to or connected with the business are deemed included in the sale.

The above explanation makes other options incorrect.

17. A. Only statements 1, 4 and 5 are correct. The franchise agreement of the seller may have a provision that the franchisor must approve the sale of business. In that event, if the sale is not approved by the franchisor, this buyer's offer would become null and void. The franchise business incurs additional operating costs because the franchisor charges regular fees from the operating income. The advantage of a franchise business is that the franchisee receives a readymade image and assistance in running the business from the franchisor.

It is incorrect the *Confirmation of Acceptance* is finally signed by the franchisor. The *Sale of Business Affidavit* is required under REBBA 2002 when the seller does not provide financial statements to the buyer.

18. C. The buyer must receive from the seller a list of items that are not included in the sale.

Other statements are incorrect. The profit and loss statement must be provided for the past 12 months or ever since the seller acquired the business. The statement related to assets and liabilities of the business is not for the past 12 months. When financial statements are not available, the *Sale of Business Affidavit* is to be completed by the seller and not by the listing brokerage.

19. A. The R/U factor is the relationship between total rentable area of the building and total usable area. It is same for the entire building and for every tenant. This factor is typically specified by landlord's architect.

The rent charged from tenants is based on rentable area and not the usable area. It is incorrect to state that when rentable area is used for rent calculations, the additional rent is not applicable. A commercial landlord is not required to give 60 days' notice for termination of lease.

20. C. In a *Triple Net Lease (Net/Net/Net Lease),* the tenant is required to pay all expenses including expenses incurred in repairs of major structural components. This is also known as 'carefree to the landlord' lease.

MiniCram

In a *Single Net Lease (Net Lease),* the tenant pays the base rent and certain other expenses as defined in the lease. In a *Double Net Lease (Net/Net Lease),* the tenant pays maintenance expenses, operating expenses and property taxes. The term percentage lease allows the landlord to share certain percentage of gross sales of a tenant over and above the base minimum sale.

21. B. Commercial rents are subject to *Harmonized Sales Tax (HST).* HST is applicable to both the base rent and the additional rent charged by the landlord.

The *Agreement to Lease-Commercial* form does not require that all services are to be paid for by the tenant or the tenants are required to pay for the signage. These terms may be mutually agreed between the parties. This form also does not mandate signing of a formal lease before the start date of the lease.

22. D. The pre-printed wording of *Agreement to Lease - Commercial* permits the tenant to assign the lease or sublet the premises only with prior written consent of the landlord, which the landlord shall not withhold unreasonably.

Even if the landlord gives written consent for the assignment or sublet, the agreement wording provides that the tenant shall remain liable to the landlord for lease obligations throughout the term. There is no provision in the *Assignment* clause that the landlord reserves the right to terminate lease when the tenant makes a request for assignment or subletting.

23. C. This statement is incorrect. A default on lease payments is not as onerous as default on mortgage payments. This is a definite advantage to a tenant who does not want to invest all his financial resources on purchase of commercial space and later, circumstances force him to go into payment default.

Other statements regarding tenant's perspective in leasing commercial space instead of buying are correct.

24. C. When a property owner is in default of tax payments the municipality typically issues a *Tax Arrears Certificate* and provides the owner with a copy of that. This certificate includes the amount required to pay the tax arrears. This is known as *Cancellation Price*.

Other statements are incorrect. The owner does not lose ownership upon registration of *Tax Arrears Certificate*. Tax sales may be done by either the *Tender* method or by *Auction* method. If the property is auctioned, it is subject to minimum bid. The municipality must cancel the *Tax Arrears Certificate* upon receipt of arrears. It is not automatic.

25. A. The *Harmonized Sales Tax (HST)* applies to most sales of real property unless there is an exemption such as residential resales or residential leases.

While resale homes may be exempted from HST, commercial resales are not. Registrants should not use the words '*Included In'* for HST because HST is payable in addition to the purchase price. There are no such criteria that an apartment building would be subject to 50% HST if all units are used as residential.

26. B. The *Ontario Brownfields Statutes Law Amendment Act* provides for identification, clean-up and revitalization of abandoned or contaminated lands. This law simplifies the

MiniCram

redevelopment process by amendments in the Municipal Act and the Planning Act. The law also provides certain protection to buyers/developers against future environmental liability.

27. D. Non-resident sellers must pay *Capital Gains Tax* on sale of real property in Canada. If the seller fails to pay the Capital Gains Tax, the buyer becomes responsible.

The *Residency* clause in the *Agreement of Purchase and Sale-Commercial* has three options for the protection of the buyer. The seller may provide a certificate from Minister of National Revenue after paying necessary *Capital Gains Tax*, credit the buyer for the amount of tax payable or provide a statutory declaration that the seller is not a non-resident.

28. A. The undepreciated capital cost of an asset is the cost of the asset less any capital cost allowance already claimed. There are several methods for calculation of capital cost allowance. Further, the allowance varies with the class of asset, as provided by *Canada Revenue Agency*.

Recapture of capital cost allowance occurs only if the value of certain improvement is maintained or has increased since acquisition. The half year rule does not state that 50% capital cost allowance is applied if the asset is purchased after July 1st. Instead, the half year rule states that only 50% of the cost is used for capital cost allowance calculation during the year of purchase. The declining balance method of calculation applies to most assets but certain assets such as leasehold improvements use the straight-line method.

29. A. An application for expansion of a legal non-conforming use is considered by a municipality from several aspects. Three major factors are considered- (i) significant departure from existing use, (ii) level of intensification for the local area (impact on adjacent owners), and (ii) interests of the community.

30. C. Real estate registrants can reduce their liability by making sure that an up-to-date survey of the property is obtained from the sellers. Not doing that or relying on an outdated survey is not recommended because the old survey may not show recently created easements.

Other options correctly state how a registrant can reduce his/her errors and omissions risk.

31. D. Only statements 3 and 5 are correct. Location of a nearby medical waste plant might have contaminated the land and attached a stigma to the subject property. Stigma is a material fact and must be disclosed when listing and selling the property. Even when the contamination is removed, the stigma remains attached to the property and negatively affects its value.

Further, it takes a long time to sell such a stigmatized property. Phase 1 audit involves visual inspection but does not involve any tests. Phase 2 audit involves sampling and testing but the remedial action is completed in phase 3.

32. C. As per pre-printed wording of the *Residency* clause in the *Agreement of Purchase and Sale - Commercial,* the non-resident seller has these options – (i) pay the capital gains tax in advance and deliver a certificate from Minister of National Revenue to the buyer, or (ii) credit the buyer for the amount of the capital gains tax, or (iii) provide a declaration that he is not a non-resident.

MiniCram

It is incorrect that every seller must pay *Capital Gains Tax* or that the buyer of property from a non-resident seller must get credit from the seller. There is no such requirement that every seller must provide a declaration that he is not a non-resident.

33. C. Open house is one of the several prospecting techniques. The salesperson permits potential buyers to view the property without the need to make an appointment and also gets a chance to meet new prospects. In addition to this, the seller is convinced that the salesperson is making a sincere effort to sell the property.

34. B. Writing on someone's *Facebook* wall, *Twitter* posts and blogs are some examples of exceptions under *Canada's Anti-Spam Legislation (CASL).*

Other methods of unsolicited electronic messages for promoting services or products may be under CASL.

35. D. 26,000 Square Feet.

Building Size = Gross Lot Area X Floor Area Ratio

= 8000 X 3.25 = 26,000 Square Feet

36. B. $19.23

Total Land Cost = 335,000 X 1.8 = $603,000

Total Area = 1.8 X 43,560 = 78,408 Square Feet

Buildable Land Area = 78,408 X 40% = 31,363 Square Feet

Buildable Land Cost Per Square Foot = 603,000 ÷ 31,363 = $19.23

37. D. 8.46%; 11.39%

Equity = 1,250,000 — 900,000 = $350,000

Annual Debt Service = 5,493.52 X 12 = $65,922.24

Cash Flow = 105,800 — 65,922.24 = $39,877.76

Overall Rate of Return = 105,800 ÷ 1,250,000 X 100 = 8.46%

Equity Return = 39,877.76 ÷ 350,000 X 100 = 11.39%

►***Tip****: Ignore the interest rate and amortization when the monthly mortgage payment is given.*

38. C. 2.25

Gross Profit Multiplier = 540,000 ÷ 240,000 = 2.25

►***Tip****: Ignore the List Price as well as the Operating Expenses.*

39. D. $19,200

Undepreciated Capital Cost in the beginning of year 1= $24,000

Equal amount of CCA is claimed in each year.

CCA for each year = 24,000 X 10% = $2,400

MiniCram

Undepreciated Capital Cost at end of 2 years

= 24,000 — (2,400 X 2) = $19,200

40. B. $6,900; $27,120

<u>Part I:</u> Tax Year 2013

Total Undepreciated Capital Cost (UCC) = 28,200 + 12,600 = $40,800

CCA on Previous UCC Amount = 28,200 X 20% = $5,640

CCA on New Purchase in 2013 = 12,600 X 10% = $1,260

CCA for Year 2012 = 5,640 + 1,260 = $6,900

UCC as of December 31, 2013 = 40,800 – 6,900 = $33,900

<u>Part II:</u> Tax Year 2014

UCC as of Jan 1, 2014 = $33,900

CCA for 2013 = 33,900 X 20% = $6,780

UCC as of December 31, 2014 = 33,900 – 6,780 = $27,120

►***Tip****: Ignore the date of purchase because this is an existing business.*

Case Study – 2 Parts

41. B. The purpose of including the *Expense Stop* clause in a commercial lease is to set the maximum amount of concessions the landlord will give to the tenant for leasehold improvements.

It is not correct that the *Expense Stop* clause limits the amount a tenant is permitted to spend for improvements. The provisions for removal of fixtures are not in the *Expense Stop* clause. This clause also does not specify the minimum amount the tenant is required to spend on improvements.

42. B. Only statements 2 and 5 are correct. The '*Deferment of Opening'* clause states that the tenant must open his store for business on the official opening date of the shopping centre. Also, the landlord will not be liable for any damages in case the official opening date is deferred for some reason.

Other statements are incorrect. The clause mentions that the tenant may be liable to the landlord if he fails to open the store on the official opening date. If the official opening date is deferred by the landlord, the tenant's lease will not start until the new opening date.

Case Study – 3 Parts

43. C. $25,064.25

Additional Rent = 438,800 ÷ 37,465 X 2,140 = $25,064.25

MiniCram

►***Tip***: *Ignore the per square foot Base Minimum Rent of $10.50 because the question does not ask about total Base Minimum Rent. Also, there is no need to calculate the R/U Factor.*

44. B. $17.96

Base Minimum Rent = 2,840 X 15.50 = $44,020

5.75% of Gross Sales = 850,000 X 6% = $51,000

Total of Base Minimum and Percentage Rent = $51,000

Per Square Foot Rent = 51,000 ÷ 2,840 = $17.96

►***Tip***: *Ignore the Common Area Maintenance (CAM) and the Total Rentable Area of the mall because the question does not ask about Additional Rent.*

45. A. The rent in Westgate Mall - $19.26 per Square Foot is economical. The rent in Eastgate Mall is $20.59 per Square Foot.

<u>Eastgate Mall</u>

Total Rent for the First Year = 15,788 + 3,338 + 36,838 = $55,964

Calculate Concessions

2 Month's Base Minimum Rent = 15,788 ÷ 12 X 2 = $2,631

Improvement Concession = $10,000

Rent Payable in First Year = 55,964 – 2,631 – 10,000 = $43,333

Per Square Foot Rent = 43,333 ÷ 2,105 = $20.59

<u>Westgate Mall</u>

Total Rent for the First Year = 13,838 + 6,350 + 31,775 = $51,963

Calculate Concessions

3 Month's Base Minimum Rent = 13,838 ÷ 12 X 3 = $3,460

Improvement Concession = $7,000

Rent Payable in First Year = 51,963 – 3,460 – 7,000 = $41,503

Per Square Foot Rent = 41,503 ÷ 2,155 = $19.27

Case Study – 5 Parts

46. B. The advertisement does not clarify exactly what is meant by '*net'* amount. The buyer must be concerned whether this amount is *gross* before expenses or *net* after expenses. Ideally, the buyer should seek more clarification by requesting the seller to provide financial statements of the business.

47. D. The buyer must demand copies of equipment lease contracts to know his obligations under these contracts. Some other concerns for the buyer include, but not limited to, amount of lease, lease expiry, renewal terms, maintenance of equipment, service timings, etc.

MiniCram

48. B. $147,655

Calculate Weighted Average of Profits

39,300 X 1 = 39,300

35,550 X 2 = 71,100

32,400 X 3 = 97,200

27,280 X 4 = 109,120

25,250 X 5 = 126,250

Weighted Average = (39,300 + 71,100 + 97,200 + 109,120 + 126,250) ÷ 15 = $29,531

Estimate of Value = 29,531 ÷ 0.20 = $147,655.

49. B. Only statement 3 is correct. The mortgage financing condition may be written as a '*condition precedent'* or as a '*condition subsequent'*. The given format is *precedent,* and this format typically includes a *waiver* provision for the benefit of the buyer.

It is not necessary that the condition be written in *subsequent* format. A condition precedent for mortgage financing need not include the amount of the loan or the name of lender. It is not unlawful to write the word '*satisfactory'* instead of actual mortgage loan.

50. B. Only statements 2 and 4 are correct. The clause should mention the 12-month period for which the profit and loss statements are provided. For example, the clause should specify the period such as '*period ending December 31, 20xx'*. Furthermore, there is no mention of statement of assets and liabilities of the business, which is a requirement under *REBBA 2002*.

It is not necessary that the clause must be written as a condition. The financial statements need not be provided in the form of a statutory declaration. These are typically prepared by seller's accountant. There is no problem in including an acknowledgement that the seller has received and reviewed a copy of the lease.

Back to Sample Exam 1 Back to Table of Contents

MiniCram

DETAILED ANSWERS

SAMPLE EXAM 2

1. C. Lifestyle centers typically provide for an open-air shopping experience rather than some enclosed shopping mall. They have tree-lines streets, on-street parking, boutique merchandisers, entertainment facilities, fashionable restaurants, and even business offices.

Lifestyle shopping centers are different than enclosed shopping centres because enclosed shopping centres do not have open-air facilities that are typically found in lifestyle centres. It is also incorrect that lifestyle centres do not include business offices or the initial investment for the developer is huge.

2. A. It is incorrect that Class C buildings are always more than 30 years old or they must be renovated before being leased. In general, the classification criteria is that these buildings are typically more than 20 years old and may need extensive renovation.

Other statements regarding building classifications are correct.

3. B. Large industrial users typically do not ignore characteristics of the community. This is particularly true for labour intensive industries which must study community profile to ensure that labour force is available.

Other statements with respect to industrial real estate are correct.

4. A. It is incorrect that centre-core designs in multi-storey office buildings are better suited for larger tenants. These designs are, in fact, better suited for buildings where multiple tenants would need office space.

Other statements regarding centre-core and side-core are correct.

5. C. Steel construction is preferred for most industrial structures because steel provides strength as well as flexibility to the structure during high winds. Most modern small and medium-sized buildings use a combination of concrete and pre-engineered steel.

It is incorrect that steel structures are expensive. They are, in fact, inexpensive as compared to complete concrete structures. All industrial buildings are not built as *general-purpose* buildings and it is not easy to alter the design for heavy industrial uses once the construction is complete. Most industrial structural designs consider bay depth, clear height, clear span and many other aspects for a variety of light and heavy industrial uses.

6. B. A *Land Development Agreement* is typically required by municipality as a condition for amendment of zoning for a specific property is the application is approved.

Other given situations do not require the developer to sign a land development agreement with the municipality. There may be other zoning requirements for these projects.

7. B. Although every individual investor in a joint venture has undivided interest in the project, it is not necessary that they are issued equal shares. The shares are proportionate to their investment.

MiniCram

Other statements are correct. In a partnership, all partners have personal liability for the business and there is no legal separation. A corporation is a legal entity separate from its shareholders. In certain situations, personal liability of shareholders may be attached. A *Real Estate Investment Trust (REIT)* may be involved in only financing of real estate projects or ownership of real estate or both.

8. C. A site plan is typically attached to the lease to specify location of the unit, its size and boundaries.

Other options do not describe the correct information or purpose of a site plan.

9. B. The *Rentable Area* of a unit is typically used for calculating rent for a particular tenant. This is calculated by multiplying the *Usable Area* of the tenant with the applicable R/U factor of the shopping centre.

10. C. The *Commercial Tenancies Act* does not mandate approval of all subtenants by the landlord. The landlord may have a provision in the head lease that he must approve the subtenant before the sublease between the tenant and subtenant becomes binding.

Other statements with respect to subtenancy of a commercial retail unit are correct.

11. A. If a commercial tenant files for bankruptcy, the indemnifier for the tenant may still be held responsible for lease obligations. The scope of liability for a guarantor is limited because if the tenant files for bankruptcy, the guarantor's liability also comes to an end.

The *Commercial Tenancies Act* does not require the landlord to pay interest on security deposit. The *Continuous Use* clause is typically included in most commercial leases because the landlord does not want to create a dark space in the shopping centre. This Act also does not prohibit the landlord from collecting advance tax payments from tenants.

12. C. If a property owner does not agree with the assessment value, he may either file a *Request for Reconsideration* or may directly file an appeal with the *Assessment Review Board*.

The *Ontario Municipal Board* and the local *Committee of Adjustment* are not involved in tax related matters.

13. C. Due diligence in a typical commercial real estate transaction involves inspection of various financial, legal, structural and environmental documents related to the property. The buyer needs to ensure that he will not be held liable for any problems after the closing.

It is incorrect that due diligence is needed only for vacant industrial land and not for buildings. Due diligence for a specific property may include environmental audit because of imputed costs involved in any future liability due to existing environmental hazards.

14. B. A hydrogeological report is typically required as part of the zoning amendment application when a community or private septic system is needed.

It is incorrect that amendment to *Official Plan* always involves conditions to be fulfilled. Consultations with municipal planning officials are required but this does not waive the

MiniCram

requirements under the *Planning Act*. It is incorrect that no public agency can raise any issue after approval of the developer's plan.

15. D. A multi-residential apartment building is a commercial property. The buyers would most likely demand confidential financial information from the sellers which is typically not a part of agreement for a single family residential agreement. The buyers need to be satisfied with financial, legal and operational aspects of the property.

Since single family homes are residential properties, the same agreement cannot be used for multi-residential properties. A list of appliances must be provided to the buyer because these items are typically owned by the owners and not by tenants. A home inspection clause is not adequate to inspect the structural integrity of a multi-residential building.

16. B. A confidentiality agreement may be signed by the buyer to convince the seller that the financial statements of the property would not be disclosed to any third parties.

A statutory declaration is not required in this situation and verbal assurances are not recommended in real estate. An assurance from the co-operating brokerage that the buyer would sign a binding agreement is not advisable because the buyer may refuse to buy the property after review of the financial statements.

17. B. Only statements 1 and 3 are correct.

A sale/leaseback arrangement is a good option for owners when they want to free up their equity in a commercial property but do not want to relocate their business to another location. The owner may sell the property to an investor and enter into a long-term lease of the same property. It is beneficial for both the seller and the investor because the objectives of both parties are met with this arrangement.

18. B. Analysis of investment real estate includes both the operations cash flow as well as the sale proceeds cash flow.

Operations cash flow refers to periodic monies received from operation of the commercial property during the period of ownership. It is incorrect that the after-tax cash flow is not important. In fact, most analysts prefer after tax cash flow because this provides a better picture of the return on investment. Leverage is also an important aspect of analysis.

19. A. Only statements 2 and 5 are correct. In a *Design/Build* arrangement, the landlord builds a structure based on specific requirements or design provided by a long-term tenant. Design/build arrangements are popular when the demand for commercial leasing space is high and available industrial space is low.

It is incorrect that developers do not take much interest in design/build options because such arrangements reduce their return on investment. A design/build arrangement is different from a sale/leaseback arrangement. Commercial tenants also analyze market data before entering into any commercial tenancy agreement.

20. D. Only statements 1, 3 and 4 are correct. In order to receive tax reduction, the farming business must meet certain qualifying criteria as given in these statements.

MiniCram

It is incorrect that all farming businesses receive at least 50% tax reduction. Also, if not wholly owned by a Canadian citizen or permanent resident, at least 50% of voting shares of the business must be held by a Canadian citizen or a permanent resident.

21. D. Only statements 1 and 4 are correct. A sale/leaseback agreement is beneficial to both the seller and the buyer. It allows the seller to sell his property to an investor and lease it back on a long term to retain the location. The seller can free up his equity in the property to make investment in other projects while the buyer, as investor, gets a long-term tenant.

It is incorrect that the seller always includes an '*option to purchase'* clause to buy the property back after expiry of the lease term. A sale/leaseback agreement must not be confused with '*tenant's first right of refusal'* in lease agreements. It is also not correct that sale/leaseback is popular when the building is in poor condition.

22. C. Investment in commercial real estate has certain advantages. One such example is that the investor can grow the invested capital by refinancing of the property after many years of ownership when sufficient equity has been built up.

It is incorrect that commercial properties always have lower property taxes than residential properties. Lenders require higher down payment (initial investment) when providing loans for commercial properties. Liquidation refers to the ease by which assets can be converted to cash and it is incorrect that a commercial property can be sold and liquidated quickly. It takes time to sell a commercial property.

23. D. Only statements 2, 3 and 4 are correct. Franchise businesses have both advantages and disadvantages. The franchisor typically provides training to the owners and staff; and may help in reducing the cost of goods due to its bulk purchasing power. Later, the value of the business may increase because of the franchise arrangement.

It is incorrect that the on-going costs and fees are not significant, or the owner is always free to sell the business without the consent of the franchisor.

24. B. A commercial tenant is not permitted under the *Commercial Tenancies Act* to withhold rent if the landlord fails to fulfill obligations under the lease contract.

Other statements are correct. Upon default in rent payment, the landlord may change the locks of the unit 15 days after the rent became due. Both the landlord and the tenant may approach *Superior Court of Justice* in case of a dispute. The landlord is permitted to seize and dispose of tenant's property to recover rent payments, subject to certain conditions.

25. B. Under the provisions of the *Commercial Tenancies Act*, if the lease is for a fixed term, the tenant must vacate the premises on the last day of lease term, unless the lease is renewed.

The landlord must honour lease obligations and cannot unreasonably give 30 days' termination notice to the tenant. It is also incorrect that the landlord must wait until end of lease term to give termination notice. An *overholding tenant* who continues to occupy the premises after the expiry of the lease may be liable for two months of rent every month. It is incorrect that the tenant must pay two months' rent as security deposit.

MiniCram

26. C. The *Agreement to Lease - Commercial* sets out the fundamental material aspects of the lease between the landlord and the tenant. If the parties agree, this form itself may constitute the entire formal lease.

It is incorrect that the landlord cannot add more clauses in the formal lease. The landlord typically adds many clauses appropriate to the commercial tenants in the final lease. The pre-printed wording of the *Agreement to Lease - Commercial* does not make it mandatory that the landlord and the tenant must execute a formal lease. In all cases, a commercial lease agreement must be in compliance with the *Commercial Tenancies Act*.

27. A. The amount of income being reported is not one of the factors considered by the *Tax Court of Canada* when deciding whether the gain is capital gain or regular business income.

Other options are correct regarding the factors considered by the *Tax Court of Canada* while settling a capital gains related dispute.

28. A. The purpose of the *Ontario Brownfields Statute Law Amendment* is to encourage clean-up and redevelopment of abandoned or contaminated lands. This law makes redevelopment procedures easier by making certain amendments to the *Municipal Act* and the *Planning Act*.

This law does not require that every industrial land buyer completes the *Record of Site Conditions* report. This report is required for redevelopment of brownfields only. This law also does not waive the requirements of the *Environmental Protection Act*. The law encourages municipalities to make the redevelopment process easier rather than making it strict.

29. D. Under the federal *Bankruptcy and Insolvency Act*, the *Receivership* option is valid only for companies and not for individuals.

Other statements with respect to provisions of the *Bankruptcy and Insolvency Act* are correct.

30. C. A salesperson may be hired by a brokerage as an independent contractor or as an employee. It may not be possible for an employee salesperson to decide or alter the commission policies of the brokerage.

A salesperson working as independent contractor uses his own judgement and methods and decides himself/herself what commission is charged from clients. The salesperson working as an employee may not be able to work in the same manner.

31. C. The *National Do Not Call List* provides certain exemptions to real estate brokerages for making calls to consumers when the brokerage has an existing business relationship with the consumer. When a party has an existing or expired agreement with a brokerage, the brokerage is deemed to have an existing business relationship with that consumer. In this case, the brokerage is permitted to contact the consumer for up to 18 months of signing the agreement.

32. A. 2.6

Floor Area Ratio = Gross Floor Area ÷ Gross Lot Area

= 12,480 ÷ 4,800 = 2.6

MiniCram

33. C. 12.88%

Land Cost = 3.5 X 275,000 = $962,500

Buildable Area = 3.5 X 43,560 X 35% = 53,361 Square Feet

Buildable Land Cost Per Square Foot

= 962,500 ÷ 53,361 = $18.04

Construction Costs = 14.55 + 43.95 + 12.75 = $71.25 per Square Foot

Total Land and Building Costs = 18.04 + 71.25 = $89.29 per Square Foot

Return on Investment = 11.50 ÷ 89.29 X 100 = 12.88%

34. A. 8.51%

Part I: Calculate Annual Debt Service

Down Payment = 6,500,000 X 35% = $2,275,000

Mortgage Loan = 6,500,000 X 65% = $4,225,000

Annual Debt Service = 4,225,000 X 6.5% = $274,625

►***Tip***: *For Interest Only mortgage, simply multiply the loan amount with interest rate to calculate the annual debt service.*

Part II: Calculate Net Operating Income

Operating Income = 1,150,000 – 4.5% + 29,800 = $1,128,050

Annual Expenses = 1,128,050 X 58.5% = $659,909

Net Income = 1,128,050 – 659,909 = $468,141

Part III: Calculate Cash Flow and Equity Return

Cash Flow = 468,141 – 274,625 = $193,516

Equity Return = 193,516 ÷ 2,275,000 X 100 = 8.51%

35. A. $132,210

Calculate Weightage Average of Profits

137,800 X 4 = $551,200

132,000 X 3 = $396,000

126,200 X 2 = $252,400

122,500 X 1 = $122,500

Add all these numbers = 1,322,100

Divide by 10 (4+3+2+1) = 1,322,100 ÷ 10 = 132,210

Weighted Average of Gross Profits = $132,210

MiniCram

36. B. $795,000; $16.50

Base Minimum Rent = 2,650 X 16.50 = $43,725

Base Minimum Sale = 43,725 ÷ 5.5% = $795,000

Percentage of Gross Sales = 640,000 X 5.5% = $35,200

Percentage Rent is Not Applicable or is Zero.

Total of Base Minimum and Percentage Rent = $43,725

Per Square Foot Rent = 43,725 ÷ 2,650 = $16.50

►***Tip****: Percentage Rent is not payable if the Gross Sales do not exceed the Base Minimum sale of $795,000. In this case, the Base Rent per square foot itself becomes the 'Total of Base Minimum and Percentage Rent' per square foot.*

37. C. $2,695.54

Total Rentable Space for calculation of property tax

= 240,000 — 4,500 = 235,500

Proportionate share of Cram Cookies Inc.

= 276,000 ÷ 235,500 X 2,300 = $2,695.54

38. A. $21.96

Part I: Base Minimum Rent = 1,800 X 12.50 = $22,500

Percentage Rent = $6,750

Additional Rent = 1,800 X 15.50 = 27,900

Total Rent for the First Year = 22,500 + 6,750 + 27,900 = $57,150

Part II: Concessions

3 Month's Base Minimum Rent = 22,500 ÷ 12 X 3 = $5,625

Improvement Concession = $12,000

Part III: Rent Payable in First Year

= 57,150 – 5,625 – 12,000 = $39,525

Per Square Foot Rent = 39,525 ÷ 1,800 = $21.96

39. C. $921,984

Improvement Allocation at the time of Purchase = $980,000

CCA for Year 1 = 980,000 X 2% = $19,600

Undepreciated Capital Cost of Improvements at the end of Year 1

= 980,000 – 19,600 = $960,400

CCA for Year 2 = 960,400 X 4% = $38,416

MiniCram

Undepreciated Capital Cost of Improvements at the end of Year 2

= 960,400 – 38,416 = $921,984

►***Tip***: *Land does not depreciate. CCA is calculated only on Building and Improvements. The calculation is similar to Office Equipment and Furniture, only the CCA rate is different,*

40. A. $265,877

Improvement Allocation at the Time of Purchase

= 2,440,000 X 65%

= $1,586,000

Improvement Allocation at the Time of Sale

= 3,280,000 X 60%

= $1,968,000

The entire CCA amount that has been claimed, i.e. $265,877 would be recaptured.

►***Tip***: *The improvement allocation at the time of sale is greater than the allocation at the time of purchase.*

Case Study – 2 Parts

41. A. The *Overholding* clause states that when the lease term expires, the tenant would become a month-to-month tenant. In this situation, the landlord may charge two months of rent for every month of possession by the tenant. The clause also states that, even if this provision takes effect, the tenant still has an obligation to deliver vacant possession of the unit after expiry.

Other statements give incorrect interpretation of clause wording.

42. B. Under the *Commercial Tenancies Act,* if the tenant is in default of rent payments, the landlord has the right to seize and dispose of tenant's assets in order to recover his monies. But the landlord cannot seize any asset that is not owned by the tenant. This is why the landlord wants to ensure in the *No Encumbrances* clause that any fixtures or assets seized are not subject to any prior claim.

It is incorrect that the landlord agrees to allow the tenant to pledge the value of the lease as security for any future financing. The tenant also does not need landlord's written consent to purchase any fixtures or equipment. The clause does not transfer the ownership of any fixtures or chattels to the landlord.

Case Study – 3 Parts

43. C. Buyer may buy only assets of the business, which include stock, assumption of lease and the goodwill. In this case, the company/corporation is not purchased by the buyer.

A higher capitalization rate results in low value for the business and vice-versa. It is incorrect that businesses are easier to finance. Even the government regulations do not permit a loan to value ratio (LTV) of more than 75%. It is the buyer (not the seller) who prefers *earnout* method of financing. *Earnout* financing is based on actual performance of business after closing. It helps the buyer decide the difference between seller's asking price and what the buyer wants to pay.

44. D. The students answer is unacceptable because he did not describe that the buyer must receive a list of items (fixtures, chattels, goods or other assets) which are *not* included in the sale. If such a list is not provided, then all such items are deemed included in the sale. This explanation makes other options incorrect.

45. A. In case the business being sold is a franchise business, it is not necessary that the franchisor would demand the franchise fee again. The franchise fee is typically a one-time fee and is already paid. It is incorrect to state that the franchisor would make the sale void if the franchise fee is not paid again. Other statements provided by the salesperson are correct.

Case Study – 5 Parts

46. B. Most commercial sales and leases are subject to HST. When the words '*In Addition to'* are inserted in the clause, HST becomes buyer's responsibility, if it is applicable.

In the pre-printed wording of standard *Agreement of Purchase and Sale – Commercial*, there is no option to insert '*In Addition To'* or '*Included In'*. The words '*In Addition to'* are pre-printed in the agreement.

47. A. Fax numbers or email addresses are left blank in case of multiple representation. This is clearly written in bold in the *Notices* clause.

Leaving the *Notices* clause blank is not a critical mistake and does not make the agreement null and void. A *Buyer Customer Service Agreement* does not make the buyer a client of the brokerage and is not represented. In the given scenario, the buyer is a client and it is a multiple representation situation.

48. B. The condition inserted in the Schedule A is not written properly. There is no provision in the clause that the assumption of mortgage loan is subject to approval by the lender and the agreement would become null and void if the lender does not approve the buyer as mortgagor.

49. D. The *Seller Take Back (STB)* mortgage clause should contain a *postponement* provision because the first mortgage becomes due before this second mortgage. When the first mortgage becomes due the STB mortgage will jump to the first priority and the borrower may find it difficult to renew or refinance. The postponement clause permits the borrower to renew or refinance the first mortgage by maintaining its priority.

50. B. $75,000

►*Balance Due = Purchase Price – Seller Take Back – Assumed Mortgage – Deposits*

= 370,000 – 120,000 – 150,000 – 25,000 = $75,000

Back to Sample Exam 2 Back to Table of Contents

MiniCram

DETAILED ANSWERS

SAMPLE EXAM 3

1. C. *Clustering* refers to a mix of tenants in a shopping centre do that most consumer needs are fulfilled when the consumer visits the centre. This way, the consumer does not have to make several trips to different shopping centres in order to make purchases.

Range refers to the maximum distance a consumer is willing to travel in order to buy a specific product or service. *Threshold* refers to minimum population size required for support a business. *Competition* refers to consumer's tendency to go to the closest store if the required product or service is available at a competitive price.

2. C. A Class C office building is typically located in a less desirable are as compared to Class A and Class B buildings. They may be as older as 20 years or more, having older technology and may need renovation before a tenant can move in. These buildings attract those tenants who are looking for affordable space at low rents and who cannot afford office space in Class A or Class B buildings.

3. B. *Range* is the maximum distance a consumer would travel in order to acquire a specific product or service. This is an important aspect of analysis in commercial retail demand.

Other terms given in the options are not correct.

4. D. It is incorrect that single purpose buildings are popular only because the landlord gets a long-term tenant. In fact, single purpose buildings are least popular because of their specific design for one single use only. These buildings have little market appeal and are difficult to lease or sell once the lease of the existing tenant expires. It is also very expensive to convert the use of such buildings because of high imputed costs of conversion or demolition.

Other statements with respect to categories of industrial buildings are correct.

5. D. The investor of commercial real estate is mainly concerned with return on the invested capital, and whether a particular property fulfils his/her overall investment objectives or not. The primary analysis for the investment real estate focuses on return on investment.

Investors are rarely interested in decorative features, needs of staff or business equipment, or the visibility of a specific investment property. This does not mean that an investor would neglect all these aspects. However, the primary concern is return on investment.

6. C. When the business has marginal earning potential (little or negative profits), the valuation is typically based on adjusted book value of assets.

When gross profits vary significantly in recent years, the *weighted average* method is typically used for evaluation or for negotiations. The *discounted cash flow* method is not used for a business in leased premises but for a business in an owned premises. This method is best suited when both the business and real estate are being sold. It is incorrect that the direct method of *capitalization* is used only for rental apartment buildings and not for evaluation of businesses.

7. D. In all types of farm land lease agreements, the landlord retains the ownership of land (landlord is supplier of land) and is responsible for the property tax payments.

The *cash crop* lease authorizes the landlord to one-third of crop sales while the tenant keeps two-thirds. In *cash rent* lease, the landlord gets a fixed amount of rent for the land and typically, half rent payment is done in advance. In *flexible cash* lease, the rent paid by the tenant is based on either the price of the crop, the yield on the crop or a combination thereof.

8. B. The formal lease prepared by a landlord or landlord's solicitor is known as settled form of lease. This lease must include all the fundamental terms of lease earlier agreed in the *Agreement to Lease - Commercial* form.

The provisions under *Statute of Frauds* are for all commercial leases and not only for those where the lease term exceeds 3 years. This Act states that a lease of less than 3 years need not be in writing. When a *percentage rent* clause is included in a retail lease, the landlord may charge differing percentages from different tenants, based on their annual gross sales. Landlords typically do not rely only on estimated gross sales given by tenants but may have strict provisions for monitoring the actual gross sales.

9. B. A commercial landlord should ensure that any assignment or subletting of the premises is with prior written consent of the landlord. In addition to this, the landlord should keep a provision that he can refuse assignment or subletting on reasonable grounds.

It is incorrect that the landlord must never permit assignment or subletting. The lease should not automatically terminate when such a request is made. Also, the landlord should ensure that the tenant does not receive rents higher than what he is paying to the landlord.

10. D. The phase 1 of *Environmental Audit* involves inspection of the property and review of documents. These documents may include ministry records, previous audit reports, registry information, etc.

Other statements are correct. The scope of environmental contamination is determined from soil water sampling and testing, which is done in phase 2 of the *Environmental Audit*. It is incorrect that every buyer needs to get a phase 1 audit report for any real estate transaction if he needs mortgage financing. Obtaining *Environmental Insurance* does not mean that environmental audit is not required.

11. B. The *Half-Year Rule* for calculation of capital cost allowance applies to most capital assets and this includes real estate. As per this rule, only 50% of the cost of assets is considered for calculation of capital cost allowance in the year of purchase.

In case of a new corporation, the 50% rule applies to all new capital assets, but the days are prorated. Land and building do not necessarily have 50/50 allocation when calculating the capital cost allowance. The *Canada Revenue Agency* (not the taxpayer) provides guidelines as to what method is to be used for calculations.

12. B. An *easement* is a right given by a land owner to another land owner for a specific purpose rather than for general use. Once this right is granted, it is registered on the title of both properties.

MiniCram

A registered easement runs with land and binds subsequent owners. An easement has a different purpose from a *Private Limitation* or a *Deed Restriction*.

13. C. *Clear span* is the floor area, clear of any interference, between columns and supporting walls of an industrial building.

It is incorrect that pre-engineered industrial buildings are not popular due to their cost. *Live load* refers to the ability of the floor to support not only the structural components but also loads of people and equipment. The ability to support just the structural components is referred to as *'dead load'*. Warehouses are not typically divided into segments.

14. C. When looking for a warehousing facility, distributors mainly focus their attention on transportation corridors, time and distance factors, and freight rates. This is because the demand for industrial buildings is driven by specific functions of the buyer.

Other options are incorrect. Manufacturers concentrate on distance to raw materials, availability of energy for manufacturing and availability/cost of labour. Market based industries look for closer customer base.

15. D. The *Agreement of Purchase and Sale* for a multi-residential rental apartment building would include a requirement that the seller would provide details of all leases to the buyer. This is typically in addition to the standard clauses for providing financial statements. The buyer needs to satisfy himself with respect to compliance of the seller with the *Residential Tenancies Act,* provision for transfer of leases to the buyer and deposits they have paid.

It is incorrect that the *Commercial Tenancies Act* applies to multi-residential buildings. The responsibility to notify tenants about change in ownership lies with the seller, not the buyer. Under REBBA 2002, these buildings are considered a *business* for the purpose of sale.

16. A. The *Commercial Tenancies Act* regulates the landlord and tenant relationships for commercial buildings. It is incorrect that this Act impacts sale of a multi-residential apartment building.

Other factors mentioned in the given options may impact the marketing or sale of a multi-residential apartment building.

17. C. An investor interested in purchasing a rental apartment building would typically want to include a requirement in the *Agreement of Purchase and Sale* that the seller increases rents before the completion date subject to provisions of the *Residential Tenancies Act*. This would ensure that the return on his investment is higher, which would reduce risk to his investment.

Stability of interest rates is not an example of risk factor. Risk assessment does not merely consider yield analysis; there may be other factors as well. It is incorrect that increased risk results in higher return. When risk increases, the return tends to decrease.

18. B. If the business is operating from leased premises; the remaining term of the lease and its renewal privilege is a main concern. This is because the location is extremely important for successful operation. If the lease is not renewable or if the landlord does not agree to renew the lease, relocation may cause unexpected losses to the buyer.

MiniCram

Other statements are incorrect. Businesses are harder to finance as compared to residential properties. The *Earnout* method of financing is better for the buyer and not the seller. REBBA 2002 requirements for sale of business are applicable when a real estate brokerage is involved in the sale.

19. A. Most commercial landlords ensure that the tenant seeks prior consent before assigning the lease or subletting the premises. In the absence of such a clause in the lease, the tenant may assign or sublet without the consent of the landlord.

It is incorrect that in case of assignment, the original tenant remains liable during the entire term of the lease and landlords prefer assignment over subletting. The original tenant may be released, if the landlord elects to do so. However, in subletting, the tenant remains liable for the entire term of the lease. The common law does not prevent the tenant from assigning the lease or subletting the premises, but the landlord may insert a consent clause.

20. D. The percentage rent is based on gross sales of the tenant. This is why the landlord needs to know the annual gross sales of the tenant. In a typical retail lease, the *Gross Sales Defined* section describes the expected gross sales from a particular type of store.

Other options are incorrect reasons why the landlord needs to know the gross sales of the tenant.

21. B. The *'Rent Free'* provision in a typical commercial lease provides a concession to the tenant in the beginning of the lease. But during the rent-free period the tenant may still have to pay the additional rent as given in the lease.

When the demand for retail space is high, the landlords may not be willing to give a rent-free period. Rent free period is in the beginning of the lease term and not at the end. The Commercial Tenancies Act does not require the landlords to give three months' rent-free period. This concession is a discretion of the landlord when they want to attract tenants to the shopping centre.

22. B. The *'rentable area'* of a tenant is the actual floor area plus his proportionate share of common elements of the complex. This is calculated by multiplying the *'usable area'* with the applicable R/U factor of the building.

Accordingly, the usable area is the actual floor area of the tenant's unit. The terms '*rentable area'* and *'gross floor area'* of all buildings are not synonymous. Gross floor area refers to the total area of the building based on external measurements, excluding any unenclosed areas such as parking spaces.

23. A. The *Ontario Brownfields Statute Law Amendment Act* encourages municipalities to recognize and redevelop abandoned or contaminated land within their jurisdiction.

It is incorrect that this Act discourages municipalities redeveloping abandoned land or reduces their assessment base by decreasing the value of such lands. This Act does not make the municipalities, lenders and developers accountable if they are involved in development of such lands. The Act, in fact, encourages them to redevelop such land and includes several provisions to make the redevelopment process easy and to avoid future environmental liability.

MiniCram

24. B. The municipality is required to notify a mortgagee in case the owner has not paid the property tax. The mortgagee, in turn, has the right to prevent the municipal tax sale by paying off the *Cancellation Price* given in the *Tax Arrears Certificate*.

It is incorrect that the municipality cannot sell the property for more value than given in the *Tax Arrears Certificate.* The purpose of this certificate is not to set the value of the property but to specify the tax amount which is in arrears. It is not mandatory for the municipality to hire a registered real estate brokerage for the sale because these sales are typically conducted by auction or by public tender. The municipality cannot proceed with possession and sale if only one year's taxes are in arrears.

25. C. If a non-conforming commercial property needs to be enlarged, appropriate permits from the municipality are typically required.

Non-conformity is usually created when a specific use of the property existed before the passing of a new zoning by-law which makes that use illegal. It is not correct that non-conformity occurs only in commercial areas and not in residential. If the status of the property is a *'legal non-conforming'*, it does not become illegal when the property is sold. This status remains as such.

26. B. Real estate registrants need to be aware of visual clues of contamination. Even though a parcel of land does not have any visual clues of contamination, chances of contamination still exist because seepage of contaminants may be occurring underground from an adjacent property.

It is incorrect that the main source of contamination occurs only due to above ground storage containers. Owners of contaminated land are not only liable for their own land but may be liable to adjacent lands also if the contaminants are flowing to their land.

27. A. Registrants have an obligation of providing competent and conscientious service to their clients. The salesperson should have enquired about any such appliances or items that are not owned by the seller but belong to their suppliers.

It is incorrect that the salesperson has limited duties towards her buyer client only because this was the first time she sold a business. Salespersons must exercise due diligence and it is not a valid excuse that the buyers should themselves be aware of such matters.

28. A. In a *Limited Partnership*, there are at least two partners; a *general* partner and a *limited* partner. The general partner manages the business operation and has unlimited liability while the limited partner is a passive investor whose liability is limited to the amount invested and profits shared.

This explanation makes other options incorrect.

29. D. It is incorrect that the confidentiality agreement prohibits the brokerage to disclose any information that is generally known in the marketplace.

The purpose of the confidentiality agreement is, in fact, not to disclose the client's business information without prior consent. If the information provided by the seller is commonly known, there is no reason to keep it confidential.

MiniCram

30. C. The pre-printed wording gives several options to a non-resident seller for payment of *Capital Gains Tax*. The seller can either pay the tax in advance and deliver a certificate from the Ministry or a credit can be given to the buyer for such amount. Otherwise, a statutory declaration must be provided to the buyer stating that the seller is not a non-resident.

Other options are not entirely correct. Please pay attention to the absolute word '*must'* in these statements.

31. D. When a salesperson is working as an independent contractor with a real estate brokerage, he is himself responsible for personal taxation matters.

The brokerage does not make any tax deductions from the commission payments. However, the brokerage is responsible for the conduct of the independent contractor salesperson for compliance with REBBA 2002 regulations.

32. B. The federal telemarketing regulations are equally applicable to all businesses, including real estate registrants. It does not matter whether the registrant is involved in residential trading or commercial trading.

It is advisable that a registrant is well prepared for handling queries on the commercial property that he/she has listed. Providing accurate information is an ethical duty of the registrant. When listing a commercial property, the registrant must get information on contracts of the seller with utility and property management companies because the buyers are typically interested to get related information. New registrants should focus on smaller commercial projects in the beginning and not on larger projects.

33. D. 9,000 Square Feet

Gross Floor Area = 3,600 X 2.5 = 9,000 Square Feet.

34. C. 12.75%

Land Cost = 5 X 245,000 = $1,225,000

Buildable Area = 5 X 43,560 X 40% = 87,120 Square Feet

Buildable Land Cost = 1,225,000 ÷ 87,120 = $14.06 per Square Foot

Construction Costs = 10.50 + 37.95 + 12 = $60.45 per Square Foot

Total Land and Building Costs = 14.06 + 60.45 = $74.51 per Square Foot

Return on Investment = 9.50 ÷ 74.51 X 100 = 12.75%

35. A. $940,166.75 rounded to $940,000.

Gross Margin = 680,000 — 402,460 = $277,540

Net Profit = 277,540 — 32.25% = $188,033.35

Value = 188,033.35 ÷ 20% = $940,166.75

Rounded to $940,000

MiniCram

36. B. 2,282 Square Feet

R/U Factor = 128,000 ÷ 110,500 = 1.15837

Rentable Area for Tenant = 1,970 X 1.15837 = 2,282 Square Feet

►***Tip****: When calculating R/U Factor, use at least 4 or 5 decimal places for accuracy.*

37. D. $29,232.54

Additional Rent = 856,700 ÷ 68,870 X 2,350 = $29,232.54

►***Note****: Take the Usable Area as it is known for both the tenant and the shopping centre. Do not calculate the R/U factor or tenant's rentable area because it is not required for this question.*

38. A. $29,700; $540,000; $8,800

Base Minimum Rent = 2,200 X 13.50 = $29,700

Base Minimum Sale = 29,700 ÷ 5.5% = $540,000

Percentage of Gross Sales = 700,000 X 5.5% = $38,500

Rent Payable in the First Year = $38,500

►***Note****: The total rent payable is the 'Total of Base Minimum and Percentage Rent'.*

Percentage Rent = 38,500 – 29,700 = $8,800

39. C. $167,750

Capital Gain = 1,350,000 – 950,000 – 64,500 = $335,500

Taxable Capital Gain = 335,500 X 50% = $167,750

►***Tip****: Ignore other amounts when the adjusted cost base is given.*

40. B. $880,589.

Building Cost = 1,560,000 X 60% = $936,000

CCA for Year 1 = 936,000 X 2% = $18,720

UCC for End of Year 1 = $917,280

CCA for Year 2 = 917,280 X 4% = $36,691

UCC for End of Year 2 = 917,280 – 36,691 = $880,589

►***Tip****: Quick Method*

936,000 – 2% – 4% = $880,589.

Case Study – 2 Parts

41. D. The purpose of the *Continuous Use* clause is to ensure that the tenant occupies the premises during the term of the lease, keeps adequate merchandise and fully staffs the operation.

If the tenant does not run the business from the leased premises but keeps on paying the rent, it would create a *dark space* in the shopping centre. This puts the landlord in a difficult situation because the missing tenant may be an anchor tenant. When an anchor tenant is missing, other tenants would not be attracted to the shopping centre.

42. D. Only statements 3 and 5 are correct. The wording of the *Intent of Lease* clause provides that the tenant shall bear all expenses for operation of the shopping centre according to his proportionate share of common areas. The tenant, however, shall not be responsible for personal income tax or the financing costs of the landlord.

Other statements give incorrect interpretation of the clause wording.

Case Study – 3 Parts

43. B. $203,740

Average of Gross Profits = 146,693 ÷ 4 = 36,673.25

Value = 36,673.25 ÷ 18% = $203,740

►***Tip****: Watch Out. Option C is '$230,740'. Seems to be a similar number.*

44. D. $223,662

Calculate Annual Profits as per Given Weightage

$47,619 X 4 = 190,476

$40,533 X 3 = 121,599

$31,975 X 2 = 63,950

$26,566 X 1 = 26,566

Weighted Average = (190,476 + 121,599 + 63,950 + 26,566) ÷ 10

= $402,591 ÷ 10 = $40,259.10

Value = 40,259.10 ÷ 18% = $223,662 (rounded)

45. A. When a business has marginal profits, the value may be estimated using the assets only. The '*goodwill*' may still have some value based on the length of time the business has been operating from the location. When the rent of the leased premises is below market rent, the goodwill of the business and the lease term may be included in evaluation.

When capitalization rate is high, the estimate of value is low. It is incorrect that financing a business is easier than financing a residential property. Buyers, and not sellers, prefer the *Earnout* method of financing because the buyers can figure out the difference between the asking price and what they are prepared to offer.

Case Study – 5 Parts

46. A. In the given situation, the salesperson may insert '*As Otherwise Specified in this Agreement'* in the *Deposit* clause and add appropriate clause in the schedule to state when the deposit would be given. This is one of the three options in the *Deposit* clause; the other two being '*Herewith'* and '*Upon Acceptance'*.

The salesperson should not give any advice to the buyer to convinces him that delays in giving the deposit is common and that he need not worry. The REBBA 2002 requirement to put the deposit amount in a *Real Estate Trust Account* is for the listing brokerage and should not be confused with the buyer's agreement to pay the deposit within 24 hours of acceptance.

47. B. A confidentiality clause is appropriate when the buyer demands financial statements of the property and the seller has some concerns. This clause ensures that the buyer will not disclose the information to any third party without the prior written consent of the seller.

Typically, the sellers provide financial statements after the agreement is accepted. It is inappropriate for the buyer to demand these statements even before the offer is accepted. A '*Pro Forma Statement'* has a different purpose and is typically prepared by the brokerage to show the expected cash flows to a prospective buyer.

48. D. Only statements 1 and 4 are correct. The deposit is typically kept by the listing brokerage in its *Real Estate Trust Account* until completion or other termination of the agreement. REBBA 2002 requires a disclosure of interest on trust funds, if any. This interest must be paid to the person to whom the funds belong, unless otherwise stated in the agreement.

Other statements are incorrect. The brokerage need not provide statutory declaration regarding deposit funds; this is taken care of by conditions. Since the seller does not keep the deposit, the seller does not have to pay any interest. A clause in the agreement for withholding 10% deposit as penalty is not advisable.

49. D. The last party to accept all terms of the offer or a counter offer signs the *Confirmation of Acceptance.* If the seller accepts the original offer without any amendments, the seller signs it. If the buyer accepts the counter offer, the buyer signs it. In this scenario, the buyer signs the *Confirmation of Acceptance* because this is the last party to accept terms of the offer.

It is incorrect that that only the seller has the right to sign confirmation, being the owner of property or the buyer signs it at the time of making the offer. Also, the seller does not sign *Confirmation of Acceptance* at the time of making amendments.

50. C. $820,000

Balance Due Upon Completion

= 1,160,000 – 40,000 – 300,000

= $820,000

►***Tip****: Do not subtract the amount of 'New' First Mortgage.*

[Back to Sample Exam 3](#) [Back to Table of Contents](#)

DETAILED ANSWERS

SAMPLE EXAM 4

1. D. '*Net Absorption Rate'* refers to the total available space less the office space vacated during a given period of time. This is preferred by commercial market analysts over other key indicators of office market.

The ratio of unleased office space to total available space is known as '*Vacancy Rate'*. Other terms do not relate to absorption rate.

2. B. One of the attractions of '*power centres'* in retail sector is that several big box stores are located in the same complex.

It is incorrect that every retail business needs to be located in a power centre or that power centres should be located in downtown core areas. They may be located at any suitable place in the town or even in suburban areas.

3. D. Investors typically look for properties with positive cash flow. But, this may not always occur as the market is dynamic. Negative cash flows may be tolerated by an investor when he believes that property values are on the rise and, in the long run, he would realize a profit.

4. C. *Market risk* from the perspective of an investor is associated with ups and downs in the real estate market, which is volatile.

Deterioration of building or some major structural problem in the building is known as *building risk*. Uncertainty in overall investment climate is known as *business risk*. Inflation results in decreasing purchasing power of dollar and this is known as *financial risk*.

5. D. The seller does not necessarily have to provide an affidavit with respect to various matters related to the business. The *Sale of Business Affidavit* is required only when the seller does not provide financial statements to the buyer.

Other statements correctly describe the documents that must be provided to the buyer before a binding agreement takes place.

6. D. The '*gross up factor'* is the difference between the rentable area and the usable area of a unit. This factor may increase the rent obligations for a tenant.

The '*efficiency factor'* for a commercial building refers to the relationship between the total rentable area and the total usable area. It is expressed as R/U Factor. The R/U Factor and the gross up factor are not synonymous terms. The rent-free period given to a specific tenant is typically calculated on base rent and not the total annual rent.

7. B. A commercial lease must have a definite term, otherwise the lease cannot be enforced. This means that the lease must include the date of commencement and the date of expiry.

There is no such requirement that the lease must be prepared under the *Short Form of Leases Act*. A lease can have any definite term, but it need not be for minimum 3 years. A lease may or may not have a table of contents for the clauses included in the document.

MiniCram

8. C. Subtenants typically study the head lease between the tenant and the landlord. If the terms are not acceptable to the subtenant, he has the right to cancel the sublease.

Other options with respect to commercial leasing are incorrect. Most commercial lease agreements include a provision that if the tenant subleases the premises, the subtenant would have a privity of contract with the landlord.

9. B. In a '*Double Net'* lease, the tenant pays a proportionate share of property taxes and expenses for minor repairs.

When the lease contains a provision that the tenant also pays proportionate share of major repairs related to the structure, the lease is known as '*Triple Net Lease'*.

10. D. The *Consumer Reporting Act* refers to a consumer as someone who is not involved in business activity. In the standard *Agreement to Lease - Commercial*, the *Consumer Report* clause is not included because the tenant would be involved in a business operation from the leased premises.

The *Family Law Act* applies to both residential and commercial properties owned by the family when calculation of net family property is done. It is incorrect that the agreements for sale and lease are prepared by the buyer brokerage.

11. B. If the land was never used before it is sold, it does not necessarily mean that environmental hazards exist on the land. Thus, the seller does not have to disclose this to potential buyers.

Other options point to a situation where land may be contaminated by hazardous materials. These must be disclosed to potential buyers when selling the land.

12. C. Zoning by-laws typically set out the maximum coverage of the land for building the structure, which is typically given as a percentage of gross lot area. This increases the cost of land when considering the actual *'buildable square foot'*.

Soft costs and hard costs are a part of investment for the developer, may not be paid by the tenant. Soft cost and development cost are not synonymous terms. In general, the developer's rate of return is certainly affected by the rental rates prevailing in the area.

13. D. The buyer of a multi-residential building might want to access financial statements of the seller to ensure that that his investment would be safe. The salesperson may include a list of selected financial statements that would be provided to the buyer. In addition to this, a *confidentiality* clause may be included to convince the seller that the buyer would not disclose this information to third parties without the prior written consent of the seller.

It is incorrect that apartment buildings are usually sold without providing financial information to the buyer.

14. A. When the buyer or seller is a corporation, the person signing on behalf of the corporation inserts signatures and, if available, the corporate seal. In case seal is not available, the person may write "*I have the authority to bind the corporation*".

MiniCram

Other statements are not correct. In case the property is held in trust, all estate trustees must sign the agreement. Power of attorney for dealing in property is not verbal but a written authority. It must be registered in land registry office. It does not matter the attorney is a relative of the registered owner or a lawyer. Only the names of registered owners need to be inserted in the agreement. It is not a required that '*all*' persons who have interest in the subject property must be shown as owners. Non-ownership interests such as a right-of-way or a mortgage lien need not be shown on the agreement.

15. B. The amount owed to others by a business is a liability and is found in the statement of assets and liabilities.

The profit and loss statement or the operating expenses do not have this information.

16. A. *Abandonment* is the act of fully and finally leaving a leased property. In such situations, the tenant does not want to return to the leased unit for resuming the business. The tenant stops paying the rent and may also leave the doors unlocked.

Eviction is an action taken by the landlord to get the unit vacated. The given scenario does not refer to a notice of termination. *Adverse possession* refers to unauthorized possession of land by someone other than the owner.

17. D. Only statements 1, 3 and 4 are correct. The landlord may include the cost of any reasonable expense such as the cost of pylon signs in maintenance expenses. The landlord may require the tenants to repairs any damage to the property. Alternatively, the landlord may repair and charge back the tenant. Most tenants agree to keep their stores open during the normal business hours of the complex but certain tenants such as restaurants or convenience stores may be permitted in their lease to stay open late.

According to the wording of the lease, most commercial landlords require prior consent for assignment of the lease or subletting the premises. It is incorrect that 'all' tenants are required to pay an equal amount towards first and last month rent. This amount typically depends on the leased area.

18. B. After the commencement, the lease becomes the enforcing document. The landlords must ensure that in case the tenant wishes to assign the lease or sublet the premises, he/she must obtain landlord's prior consent. The landlord, however, does not refuse consent arbitrarily.

Other statements are incorrect. It cannot be stated that most landlords prefer assignment or subletting. In case subletting of premises is permitted, the original tenant is still liable to the landlord for lease obligations. After the commencement, the lease is the governing document and, according to the wording of the lease, landlord's permission may be required for assignment or may not be required. Privity of contract usually does not deprive the landlord of his rights in case of assignment or subletting because the wording of the lease may not release the original tenant when assignment or subletting takes place.

19. C. This statement is related to tax sheltering. Investors typically look for such commercial properties that help them reduce or eliminate the taxes owed. The *Income Tax Act* permits owners of commercial and investment properties to claim *Capital Cost Allowance*, which generally reduces payable taxes.

MiniCram

'*Cash flow'* refers to all cash flows from the property including the *operations cash flow* and the cash flow from subsequent disposition of the property, known as *sale proceeds cash flow*.

20. B. If a taxpayer claims the profits from sale of a capital property as *Capital Gains,* the responsibility of proof is on the taxpayer. Canada Revenue Agency may accept the profits as Capital Gains provided that the taxpayer can support his claim.

Canada Revenue Agency is not required to accept any taxpayer's claim whether the profit from sale of a property is a Capital Gain or not. It is incorrect to state that the profit from sale of investment properties is 'always' treated as Capital Gain. The taxpayer cannot even get an order from Tax Court of Canada to validate his claim of Capital Gains. The Tax Court will consider several factors before arriving at a conclusion.

21. C. The purpose of *Due Diligence* documents requirement is that the buyer needs to be satisfied on matters related to the commercial property. These documents typically include information on assets, liabilities and equity of the property.

It is incorrect to state that *Due Diligence* documents are solely based on the balance of inventory or it is the same as the statement of assets and liabilities, though these are part of due diligence documents. It is also not correct to state that these documents are created only to comply with REBBA 2002 requirements. The primary purpose is that the buyer must be fully informed about financial legal, environmental and structural matters related to the subject commercial property.

22. B. Only statements 1 and 4 are correct. Registrants must be aware of visual signs or clues that indicate soil or water contamination on a parcel of land. These factors may restrict or prohibit the buyer for the proposed or intended use of the property after closing. Registrants must include appropriate clauses in the agreement to protect the best interests of the buyer. Possible soil of water contamination may also attract environment liability to the buyer.

Other statements are not correct. Registrants need not be experts in environmental matters, but awareness of possible contamination or hazardous materials is sufficient. The pre-printed '*Legal, Accounting and Environmental Advice'* clause in the agreement is only a disclaimer and not an excuse for negligence concerning environmental matters. Failing to discuss environmental concerns with a buyer may, in fact, increase the errors and omissions risk for the registrant**.**

23. D. If appropriate, the Registrar of RECO has the authority to obtain credit information or may refer to a criminal record search before approving an application for registration.

The applicant need not provide proof of any type of insurance before sending the registration application. It is incorrect to state that an employee status is beneficial for getting personal guidance as compared to independent contractor status. The brokerage is responsible to train, guide, consul and mentor both employees as well as independent contractors for trading purposes. An applicant has to sign up with a brokerage (as *employee* or as *independent contractor*) before sending the registration application to RECO.

24. A. It is correct that income from real estate trading business is unpredictable. Some new salespersons spend several months waiting for their first transaction to close.

MiniCram

If a transaction involves lengthy negotiations or complex paperwork, it is not a guarantee that the sale will close. Salespersons must use due diligence and keep aside the tax money they receive. It is not a good idea to spend that money. Commercial buyers may also back off from conditional sales and there is no guarantee that the sale will close, and the salesperson will definitely receive commission.

25. D. 10,800 Square Feet

Building Size = 7,200 X 1.5 = 10,800 Square Feet

26. B. 10.28%

Total Cost or Investment = 9.84 + 72.86 = $82.70

Net Rent = $8.50

Return on Investment = 8.50 ÷ 82.70 X 100 = 10.28%

27. B. $110,995

Annual Operating Income = 360,000 – 3.5% + 11,250 = $358,650

Annual Expenses = 358,650 X 45% = $161,393

Net Operating Income = 358,650 – 161,393 = $197,257

Annual Debt Service = 7,188.50 X 12 = $86,262

Cash Flow Before Taxes = 197,257 – 86,262= $110,995

28. C. $98,750

Value = 39,500 X 2.5 = $98,750

►***Tip****: Ignore the List Price as well as the Operating Expenses.*

29. A. $940,166.75 rounded to $940,000.

Effective Income = 680,000 — 402,460 = $277,540

Net Operating Income = 277,540 — 32.25% = $188,033.35

Value = 188,033.35 ÷ 20% = $940,166.75

Rounded to $940,000

30. B. $76,650

Additional Rent = 2,226,500 ÷ 122,000 X 4,200 = $76,650

►***Tip****: Ignore the total rentable area of the shopping centre. It is not required for calculating Additional Rent for the Tenant. Also, you need not calculate the R/U Factor.*

31. C. Nil; $8,050

Base Minimum Rent = 2,200 X 18.50 = $40,700

MiniCram

First Year

Percentage of Gross Sales = 600,000 X 6.5% = $39,000

The annual gross sales are less than the base minimum sale.

Percentage Rent is **NIL**.

Second Year

Percentage of Gross Sales = 750,000 X 6.5% = $48,750

Percentage Rent = 48,750 — 40,700 = **$8,050**

32. D. $18,458.30

Number of Days in the Year = 170 (July 15 to December 31)

CCA for Year 1 = 24,200 X 20% X 50% X 170 ÷ 365 = $1,127.12

Undepreciated Capital Cost at the end of Year 1 using *Half-Year Rule*

= 24,200 – 1,127.12 = $23,072.88

CCA for Year 2 = 23,072.88 X 20% = $4,614.58

Undepreciated Capital Cost at the end of Year 2

= 23,072.88 – 4,614.58 = $18,458.30

►***Tip****: This is a new business. Do not ignore the date of incorporation. Only the date of purchase is ignored.*

33. C. The Undepreciated Capital Cost after the first year using the 50% rule would be **$9,750**

Cost of New Purchase = $10,000

CCA for the First Year = 10,000 X 2.5% = $250

UCC After First Year = 10,000 – 250 = $9,750

34. A. $10,100; $42,800

UCC as of January 1, 2016 = $48,100

New Purchase & Disposals

Cost of New Purchase in 2016 = $15,800

Cost of Used Equipment Disposed = $12,400

Capital Cost of Used Equipment = $11,000

Take the Lesser Amount of 1 and 2 = $11,000

Net Amount of New Purchase for 2016 = $15,800 - $11,000 = $4,800

CCA Calculations

CCA for Previous Equipment = $48,100 X 20% = $9,620

CCA for Net Cost of New Equipment = $4,800 X 10% = $480

Total CCA for 2016 = 9,620 + 480 = $10,100

MiniCram

UCC As of January 1, 2017 = (48,100 + 4,800) – 10,100 = $42,800

35. D. Zero

The question clearly indicates that the property was sold only for its land value. This means that the improvement allocation at the time of sale was zero. Recapture occurs only if the value of improvement allocation has been maintained or has increased since acquisition.

Case Study – 2 Parts

36. B. Only statements 2 and 5 are correct. The purpose of the '*Damage and Destruction'* clause is to reduce the rentals payable in case all or part of premises is damaged, and the tenant is not able to use the premises. According to the wording of the clause, the tenant will not be responsible for any rent payments during the period the premises remains unavailable for use. The reduction in rent will be proportional to the area the tenant is not able to use due to damage.

Other statements are incorrect. The abatement or reduction in rent is proportional to the damaged area. The abatement will apply only when the damage is not due to the tenant or its employees. The clause does not mention that the landlord must repair the damaged premises within 10 days.

37. C. The *Damage and Destruction* clause does not state that the tenant will keep on paying the rent even if there is damage to the unit or the shopping centre. This statement is incorrect.

Other statements correctly interpret the purpose of the clause.

Case Study – 3 Parts

38. C. Statements 4 and 5 are correct. The use of the premises must clearly be specified in the *Agreement to Lease – Commercial*. Just inserting 'Retail Sales' may cause confusion between the landlord and the tenant. Instead, the words such as 'Retail Sales – Clothing Store' are more appropriate in the given situation. Also, the term of the lease must be from 1st of August to 31st of July.

Other statements are not correct. The name of the tenant '*Just for Ladies Inc.*' is correctly inserted. Karen Abdi is only the authorized signatory for the tenant corporation. The offer clearly states that the area of 2,000 square feet is '*rentable*'. The date of commencement of the lease is August 1st, according to the rentals clause.

39. D. Statements 1 and 4 are correct. The annual rent for the 1st year should be $30,000 based on $15 per square foot rent and 2,000 square feet area. The rental details for 5-year lease are not clear in the offer. These should either be spread in all five lines or there should be a note that specifies the rent structure.

Other given statements are not correct. It is not necessary to fill up all lines for rent calculations, provided a note is inserted with respect to rent structure. The monthly rent in the second line is correct as given. The first month rent cannot be deducted from rent calculations just because it is a part of the deposit amount.

40. B. Statements 2 and 5 are correct. The deposit is specified as first and last months' rent plus HST. Accordingly, it should be ($2,500 + $3,000) = $5,500 + 13% = $6,215. In case the deposit amount is payable to the landlord, the salesperson must inquire with the landlord whether they have a trust account or not. If not, the words '*and held in trust'* should be deleted.

Other statements are not correct. The deposit may be given '*Herewith'* or '*Upon Acceptance'*, whatever the case may be. It does not have to be '*Upon Acceptance'* only. It is also incorrect that the deposit *must* be payable to the listing brokerage. Since the deposit amount itself is considered prepaid rent, it is not necessary to specify it separately in the lease offer.

Case Study – 10 Parts

41. B. The *Legal Description* of the property indicates that there is a major Hydro easement. This is a valid concern for the buyer and an appropriate clause with respect to provision of an up-to-date survey of the property should be included in the Schedule.

It is incorrect that the *Legal Description* cannot include a reference to the easement. *The Agreement of Purchase and Sale* has specific space for any such reference right next to the Legal Description. The *Reference Plan* number is Plan 2432, and it is clearly provided in the Legal Description. Two lots which are owned by a single person can be sold in a single *Agreement of Purchase and Sale* because these are included in the same Reference Plan.

42. D. The *Deposit* Clause indicates that the *Deposit* is payable '*As Otherwise Described in the Agreement'*. This means that the Schedule must have an appropriate clause to describe how and when the deposit is to be paid. There is no such clause in any of the attached Schedules.

Other statements are incorrect. There is no legal requirement that the deposit amount must be minimum 10% of the Purchase price. The *Deposit* clause can include any of the three options – *Herewith*, *Upon Acceptance* or *As Otherwise Described in this Agreement*. Deposit is typically payable to the Listing Brokerage, which is XYZ Real Estate Ltd. In this scenario, ABC Realty Inc. is the Co-operating Brokerage and will not hold the deposit funds.

43. A. In a typical real estate transaction, the *Information on Brokerages* section of the *Agreement of Purchase and Sale* has information on the Listing Brokerage and the Co-operating Brokerage. In the *Notices* clause, the sellers and buyers appoint their brokerages as '*agents'* for the purpose of sending and receiving notices (documents). If the *Notices* clause does not have any fax numbers or email addresses, this may mean that the clients have given specific instructions to the brokerages that notices/documents must be delivered personally. If these fax numbers of email addresses are missing, it is not a concern or mistake in the agreement.

It is incorrect that the *Notices* clause is a mandatory clause and must be filled up. Also, it is not a multiple representation situation because the sellers and buyers are represented by two different brokerages. In a multiple representation situation, the *Notices* section is usually left blank.

44. C. The *Requisition Date* within the *Title Search* clause is selected by the salespersons and it should be after all the conditions have been either fulfilled or waived. In the given scenario, this date is before the dates mentioned in conditional clauses. This may be a concern for the buyer.

MiniCram

The *Title Search* does not typically start right after the *Confirmation of Acceptance* has been signed by the parties. *Requisition Date* is not a distinct date from the *Title Search* date, but it is just known as so because it is within the *Title Search* clause.

45. B. The *Balance Due on Completion* clause has been written very well and there are no concerns. The six essential elements of the clause are there and the amount of balance due is also correct.

The balance due is calculated by subtracting the deposits, assumed mortgages and seller take back from the purchase price.

Hence, **Balance = 925,000 – 100,000 – 345,000 – 50,000 = $430,000**

There is no need to include the actual completion date in this clause.

46. D. The *Seller Take Back* clause is written as an *agreement* clause and not as a conditional clause. The correct wording should be as follows: "*The seller agrees to take back a second Charge/Mortgage in the amount of ….*"

The words '*Not Less Than*' need not be inserted in the Seller Take back mortgage clause because the amount of mortgage has already been agreed between the buyer and the seller. These words are typically included in the '*New*' mortgage clause wherein the buyer specifies a minimum amount of mortgage loan. It is also not a requirement that the interest rate of the Seller Take Back mortgage has to be more than the interest rate of the first mortgage. Inclusion of Amortization period in a mortgage clause is optional.

47. A. The conditional clause for *Due Diligence* documents is a '*Condition Precedent*'. This type of condition typically includes a waiver provision. The given condition precedent is poorly written because the waiver provision is missing from the clause wording.

Registrants need not write each due diligence document in a separate clause and these can be grouped in a single conditional clause. There is no need for an Escape clause in this offer because commercial agreements usually take much longer time to close as compared to residential agreements. The notice of fulfillment of condition is to be sent by the buyer to the seller, as correctly given in the clause.

48. C. The signature lines for the buyer has been completed incorrectly. Although the name of the buyer corporation has been inserted, the signatures of the officer/director working on behalf of the corporation is missing.

In the given scenario, Peter M. Wilson should have signed in the space for buyers' signature. Besides this, either a corporate seal should be used or the words "I Have the Authority to Bind the Corporation" should be inserted.

49. B. The Schedule should include a *Postponement* clause because the first mortgage (*Assumed Mortgage)* expires before the second mortgage (Seller Take Back mortgage). The first mortgage comes due on 30th June 2019 while the second mortgage runs for 5 years from the date of completion up to 30th June 2022.

The *Mortgage Assumption* clause clearly states that the mortgage assumption by buyer does not need any approval from the seller's existing lender. That's why the condition part of the mortgage clause is missing, and it is correctly written. It is incorrect to state that the clause for a *New* first mortgage is missing. A new mortgage is not required in this scenario.

50. D. The date when the buyers sign the offer need not be the same date as the date on the first page of the offer. In case the buyers sign the offer a day or two later, then that date is considered the actual offer date. The date on the first page of the offer is the date of offer preparation.

The exact date of completion need not be included in the *Balance Due on Completion* clause because it is given in the pre-printed *Completion* clause. It is incorrect that the *Acknowledgement* date cannot be the same date as the date of *Confirmation of Acceptance*. Also, the *Confirmation of Acceptance* must be signed before the *Irrevocable* date.

Back to Sample Exam 4 Back to Table of Contents

THANKS FOR USING

MINICRAM NOTES

FOR YOUR EXAM PREP.

THE MINICRAM TEAM WISHES YOU ALL THE BEST FOR YOUR EXAM!

ORIGINAL AND UPDATED MINICRAM NOTES ONLY AT

WWW.MINICRAM.COM

MiniCram