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THE RESIDENTIAL RENT REGULATION ACT, 1986

and

THE RENTAL HOUSING PROTECTION ACT, 1986

Lawyers practising in real estate matters should be aware of the implications of the two above Acts relating to rental housing property. The Rental Housing Protection Act substantially limits an owner's ability to change the use of rental housing property. Under the Residential Rent Regulation Act, all rental housing property in Ontario is subject to rent control and the legality of rents and rent increases is subject to public scrutiny and control.

The attached material is an outline of some of the significant changes in the law and contains some suggestions how a solicitor might address concerns arising when acting on purchases, sales or financings of any type of apartment buildings. It is by no means exhaustive nor are the suggestions a detailed checklist of what steps solicitors should take to protect themselves and their clients. Since each transaction is different, solicitors should familiarize themselves with the implications of the Act before advising clients on transactions involving rental housing property.

Because of the significant changes in the law and the extensive regulations associated with it, and because of the limitations of the capacity of the Practice Advisory Service to respond to any volume of calls for guidance, we ask members who have questions to seek the assistance and advice of members who are knowledgeable concerning the Acts.

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THE LAW SOCIETY OF UPPER CANADA
THE RESIDENTIAL RENT REGULATION ACT, 1986
and
THE RENTAL HOUSING PROTECTION ACT, 1986

INTRODUCTION

All rental residential property in Ontario is currently subject to the Residential Rent Regulation Act, 1986, ("RRRA") and the Rental Housing Protection Act, 1986, ("RHPA"). These two Acts function in tandem to preserve the stock of rental residential accommodation in Ontario and to regulate the price at which it is available.

SUMMARY OF THE RESIDENTIAL RENT REGULATION ACT, 1986

- a) **Application:** The RRRA applies to all living accommodation used or intended for use as rented residential premises, including boarding and lodging house rooms. However, there are several limited exceptions, for example, for transient living accommodation, temporary shelters, and nursing homes.
- b) **Rent Registry:** All landlords of residential complexes containing more than six units were required by May 1st, 1987 to register the rents charged for all units as of August 1, 1985. The Act contemplates a confirmatory notice of filing being given to each Landlord and Tenant, to be followed by a challenge period when a Tenant or the Minister may attack the legality of the rent as registered.

If the challenge period expires without a successful attack having been launched, the registered rent shall be deemed to be the lawful maximum rent as of August 1st, 1985. For units where a prior rent control order has been made and the rent as of August 1st, 1985 is apparently legal in comparison with that order or only exceeds the legal rent by 5%, the challenge period is ninety days from the date of giving notice by the Minister. Where there was no prior order or the rent appears to be illegal by more than 5%, the challenge period extends for two years from the date of the Minister's giving the notice of filing. As of November 1st, 1987, no notices had been given and therefore the challenge period had not begun to run.

Registration is also required for newly constructed units within six months of the first unit being rented.

The RRRA contains several major benefits which are or were available only to Landlords who registered in a timely fashion:

1. An amnesty for illegal rent overcharges prior to August 1st, 1985;
2. For previously rent-controlled units, the right to apply to justify illegal rent increases taken before August 1st, 1985 on the basis that they would have been allowed had the Landlord made the appropriate application under the former legislation; and
3. For buildings which were not previously rent-controlled, application could be made by February 28th, 1987 to justify rents if more than the four percent statutory guideline was taken between August 1st, 1985 and January 1st, 1987;

c) **Rent Increases:** There are three ways to obtain a rent increase for a unit:

1. Take the statutory guideline, meaning the government's pre-set permitted increase:

August 1st, 1985 to December 31st, 1986:	4%
1987:	5.2%
1988:	4.7%

2. Increase the rent up to the maximum legal rent. If in one year a Landlord does not increase actual rent by the statutory guideline, the maximum rent increases in any event. In a subsequent year, the Landlord has the option of increasing the actual rent to the allowable legal maximum, which will include the statutory guideline for the earlier year as well as for the subsequent year.
3. Apply for rent review.

d) **Factors Affecting Rent Increases Above Guideline:** The Act and its regulations have substantially changed the factors for obtaining rent increases beyond the permitted guidelines. In particular, one should be aware of the following:

1. Actual increases in operating costs are no longer a general basis of increase. Instead, a flat operating cost allowance equal to the statutory guideline will usually be permitted without proof of actual increases in costs, unless costs have increased or decreased so much as to be considered "extraordinary operating costs" as defined under the Act and its regulations.
2. Post-1975 buildings (buildings first rented after December 31st, 1975) are now entitled to a specified rate of return on investor's equity as a component of rent increases.
3. The permitted statutory increase includes 1% for capital expenditures. If a Landlord includes capital expenditures in an application, the statutory guideline is automatically reduced by 1%. Therefore, if capital expenditures do not, in a twelve month period, exceed 1% of revenues, they should not be included in an application.
4. The total value of capital expenditures may not be available for inclusion in a rent increase application. The annual allowance for a capital expenditure, completed after August 1st, 1985 and included in a previous rent review order, is now deducted from the allowable cost of capital expenditure made to replace that previously permitted capital expenditure, as a "cost no longer borne".
5. Similarly, financing costs which took effect after August 1st, 1985 which were allowed in rent review proceedings and which are "no longer borne" may potentially limit the landlord's ability to increase his maximum rent.
6. Special provision has been made for the increase of "chronically-depressed" rents in pre-1976 units. However, that section of the Act has not yet been proclaimed.

e) **Procedure:** A Landlord must now serve notices of rent increase and file applications for rent review and supporting documentation ninety days prior to the first effective increase date. The application process is now entirely written. An oral hearing will be conducted only at the appeal level, if necessary.

- f) **Residential Rental Standards Board:** The Act provides for the establishment of a Residential Rental Standards Board with power to set and monitor minimum maintenance standards for residential rental buildings. Rent increases may be stayed or forfeited and rebates ordered in the event of non-compliance with the new standards.
- g) **Offences:** It is now an offence in Ontario to charge an illegal rent. It is also an offence to file false or misleading information, to increase the rent more than once in a twelve month period or to fail to file rent registry information. The penalty is a fine not exceeding \$2,000.00 for an individual and \$25,000.00 for a corporation.

SUMMARY OF RENTAL HOUSING PROTECTION ACT

a) **Prohibitions:**

The RHPA prohibits any of the following with respect to rental residential property:

1. Demolition;
2. Conversion to a condominium, co-operative, hotel, or any use for a purpose other than rental residential property;
3. Renovation or repair which requires vacant possession unless the unit is vacant for longer than one year; and
4. Severance under Section 52 of the Planning Act, 1983.

b) **Units Affected:** The Act applies to living accommodation which is:

1. Used as rented residential premises and includes boarding or lodging houses;
2. Found in municipalities listed in the regulations (population 25,000 or more); and
3. Part of a rental residential property which contains more than four rental units. (A rental residential property may be "a related group of buildings" and therefore the exemption for four or less units must not be applied simply on a building by building basis.)

However, conversion to condominium use is prohibited everywhere in Ontario and with respect to properties containing any number of units.

c) **Getting Council Approval:** In order to circumvent the prohibition, local municipal council approval is required. The municipality is not allowed to approve the application unless at least one of three criteria are met. Briefly, those tests are as follows:

1. That the premises are unsafe and unfit for human habitation;
2. That the tenants will be accommodated in similar units in the same area; or
3. That the proposal will not adversely affect the supply of affordable rental housing.

- d) **Offences:** Everyone contravening the Act and every director or officer of a corporation who authorized, permitted or acquiesced in the contravention is guilty of an offence. The penalties are a fine of not more than \$50,000.00 or imprisonment for a term of not more than one year, or both.

ACTING FOR A PURCHASER OR BORROWER

The solicitor acting for a Purchaser of rental residential property should be considering the RRRRA and the RHPA at the following stages of the transaction:

- a) **Advising the Potential Purchaser:** The Purchaser should be made aware that the legality of the rent affects the value of the property and the anticipated cash flow, since legal rents are subject to reduction. The Purchaser should be told that the use of the property cannot be changed without municipal council approval and that if it is changed without approval, the Purchaser could be forced to restore the building to its prior usage. Financing should be structured to maximize return on a subsequent rent control application.
- b) **Drafting the Agreement of Purchase and Sale:** The Purchaser's solicitor should consider including the following in the Agreement of Purchase and Sale:
1. A right in favour of the Purchaser to terminate the Agreement if the Purchaser is not satisfied that all rents currently being charged are legal, that appropriate notices have been given to validate any rent increases and that any statutory rebates have been paid.
 2. A requirement that the Vendor deliver certain documents to the Purchaser, such as rent registry forms, old rent control orders, documentation relating to any applications outstanding, current rent rolls, etc.
 3. A requirement that the Vendor advise the Purchaser of any applications or investigations which are commenced prior to closing.
 4. Extensive representations and warranties relating to compliance with the RRRRA and the RHPA, with a statutory declaration confirming same is to be delivered on closing.
 5. Security, such as a vendor take-back mortgage with a right of set-off, to protect the Purchaser in the event that any of the representations are inaccurate.
 6. A requirement that the Vendor deliver certain information needed in order to make a rent control application subsequent to closing, such as revenues and expenses for the past several years, supporting invoices and deposit receipts, contracts for capital expenditures, details of Vendor's purchase and financing, if Vendor purchased recently, etc.
- c) **Searches:** The following searches must be made:
1. Residential Tenancy Commission files, for old orders which are helpful in establishing the present legal rent limits.
 2. Rent Registry records for the building, once the challenge period has expired and the registered rents can be relied on as "legal".

3. Rent Review Services files, for details of any current applications. (This search will require the authorization of the Vendor.)
 4. Residential Rental Standards Board files, for orders which may prevent the collection of an otherwise allowable rent increase or exposure to liability rebates for rent.
- d) **Requisitions:** If the obligation to deliver rent-related documents has not been included in the Agreement of Purchase and Sale, a request for them should be included in the letter of requisitions.
 - e) **Financing Documents:** Beware of any broad statements, found in the commitment or mortgage document itself, to the effect that the property complies in all ways with the RHPA and RRRA, unless the Purchaser is in a position to satisfy itself as to these matters.
 - f) **Scope of Retainer and Reporting:** Ideally, the solicitor should limit the scope of the retainer at the outset, if he or she does not intend to give an opinion on the legality of the rents. If that was not done, this issue should be dealt with in the reporting letter, so that the Purchaser will review the rent structure with its own property management advisors and not rely on the solicitor in this regard. In this way, confirming the accuracy of the Vendor's representations will be the Purchaser's responsibility. Any necessary applications may be brought as soon as possible and any potential rebate liability, for which the Purchaser may be able to bring action against the Vendor, will be known as soon as possible.

ACTING FOR THE VENDOR

The Vendor's solicitor must have regard for the RRRA at two stages of the transaction:

- a) **Advising the Vendor Regarding the Potential Sale:** The Vendor should be made aware that the true value of the property will be directly related to the legality of the rents, and as such it should be prepared to prove the legality of the rents to the Purchaser. If it wishes to increase the purchase price, it should consider bringing a rent increase application, prior to entering into the Agreement of Purchase and Sale.
- b) **Representations and Warranties in the Agreement of Purchase and Sale:** The Vendor's solicitor should be prepared to explain to the Vendor all representations and warranties found in the Agreement of Purchase and Sale regarding the RRRA and the RHPA, and ensure that the vendor has the necessary advice to determine the compliance of his property with these statutes, even if that involves seeking outside assistance.

ACTING FOR THE MORTGAGEE

The Lender's solicitor must assist the Lender in ascertaining the true value of the property and the ability of the income stream to support the proposed financing. Therefore, the Lender's solicitor should consider the legislation at the following stages of the transaction:

- a) **The Commitment:** The commitment should require the Borrower to deliver all documentation needed to establish the legality of the rents, such as registration forms, old rent review orders, current applications, and a current rent roll. It should also

contain representations and warranties regarding compliance with both the RRRRA and RHPA, and in particular a warranty that all rents are legal and that any required rebates have been paid.

- b) **Searches:** The Lender's solicitor should conduct the same searches as the Purchaser's solicitor.
- c) **Mortgage Documentation:** The Loan should become due and payable in full at the option of the Lender in the event that illegal rents are discovered or an illegal conversion is attempted.
- d) **Scope of Retainer and Reporting:** Beware of broad statements in the instructions to solicitor and in the interim or final reports on title. It is impossible for a solicitor to give an unqualified opinion on the legality of rents and the compliance of a rental operation with the RRRRA. The Lender's solicitor should seek instructions that the statutory declaration of the borrower will be sufficient.

ACTING FOR LANDLORD OR LANDLORD'S AGENT

The Landlord's solicitor should become familiar with the following:

1. Procedure for obtaining a rent increase, especially filing deadlines, required documentation and timeframes.
2. Provisions of the Act allowing for a conditional order regarding capital expenditures, an advance ruling regarding the rents for a new building and part-building review.
3. Drawbacks to the application procedure and substantive rules. Landlords should be warned that on an application, less than the statutory guideline may be awarded. Furthermore, Landlords' solicitors should be particularly aware of the provisions regarding capital expenditures and financing costs "no longer borne" and the decrease of the statutory guideline by 1% when application is made based on capital expenditures.
4. Residential Rental guidelines and their impact.
5. RHPA provisions regarding change of use, in order that a Landlord not unwittingly breach the Act by deciding to convert without council approval and thus incur heavy penalties.