Real Estate News

Brian Hurren

Bad faith termination of residential leases in purchase and sale transactions: When is the vendor exposed?

Purchase and sale transactions involving residential properties occupied by tenants have always been part of the real estate landscape but for whatever reason, we are seeing more transactions involving these properties. It may be that with rising property values and changing neighbourhoods, owners of such properties who purchased some years ago under different conditions are now seeking to "cash out".

There are a number of issues which arise in connection with such transactions and limited space prevents anything like a comprehensive review. One of the many questions that comes up in connection with the purchase and sale of rented property, though, is the process to terminate a tenancy of a rented property which has been or is being sold. I will set aside the motives that may underlie the question for the moment and focus on process.

From a seller's perspective, the preference will always be that the buyer takes the property subject to any existing tenancy so that it will be the buyer's responsibility to take the necessary steps to terminate the tenancy. However, some buyers will want vacant possession of a property on closing so the seller has to deal with the matter.

So what are the rules?

If a purchase and sale transaction closes subject to a tenancy and the purchaser subsequently wants the unit for him or herself or, in certain situations, a close relative or caregiver, Subsection 48(1) of the *Residential Tenancies Act* (Ontario) (the "RTA") may be applicable to allow the owner to terminate the tenancy. Subsection (1) reads as follows:

> *48. (1) A landlord may, by notice, terminate a tenancy if the landlord in good faith requires possession of the rental unit for the purpose of residential occupation by,*
> *(a) the landlord;*
> *(b) the landlord's spouse;*
> *(c) a child or parent of the landlord or the landlord's spouse; or*
> *(d) a person who provides or will provide care services to the landlord, the landlord's spouse, or a child or parent of the landlord or the landlord's spouse, if the person receiving the care services resides or will reside in the building, related group of buildings, mobile home park or land lease community in which the rental unit is located.*

It is essential that personal occupancy of the unit is required *in good faith* by the owner, a spouse, child or parent of the owner, or a caregiver providing care services to one of those individuals who will also be residing in the unit. The amount of notice which must be given is at least 60 days and the date of termination of the lease must be the date a period of the tenancy ends. Among other things, this means that a tenancy for a fixed term cannot be terminated earlier than the date on which the fixed term ends. For a monthly tenancy, assuming rent is paid on the first of each month, a notice given in, say, July, will be effective to terminate the monthly tenancy as of the end of September.

Once the Tenant receives the notice of termination, the tenant may give a notice to terminate the tenancy earlier than the termination date set out in the landlord's notice. Such notice by the tenant is effective 10 days after it is given, so a landlord who gives a notice of termination pursuant to subsection 48(1) may only get another 10 days' rent from the tenant.

But what if the purchaser of a rental property requires vacant possession on closing? If the property contains no more than three rental units, subsection 49(1) of the RTA allows the owner of a rental property which contains no more than three rental units to give a notice terminating the tenancy in certain circumstances.

First, the notice cannot be given until there is an agreement of purchase and sale in place. The only alternative available to an owner who wishes to terminate a tenancy before putting a property up for sale is to reach an agreement with the tenant(s) to end their tenancy early.

Also of note, the availability of subsection 49(1) is limited to circumstances where the property is required in good

faith for residential occupancy one or more of the same list of individuals as subsection 48(1). In other words, subsection 49(1) is not a mechanism to terminate the tenancy of a tenant who is paying what might be regarded as a below-market rent simply to allow a new tenant to be found who will pay a higher rent.

As with subsection 48(1), the amount of notice which must be given is at least 60 days and the date of termination of the lease must be the date a period of the tenancy ends. A similar early termination option for the tenant also exists under subsection 49(1). It should also be noted that the date of termination specified in the notice may be prior to the closing date.

I suspect that many of us are aware of the process, at least in outline, and there are certainly many plain language how-to guides available with a simple online search to fill in any details which I have omitted. I return now to motive, and I have already alluded to an issue which is becoming more prevalent as rental properties are changing hands. This is the issue of properties currently occupied by residential tenants who are subject to rent controls and who may be paying rents which are no longer in line with fast-rising property values in the Hamilton area. What happens if a buyer is interested in purchasing a rental property to continue its use as such, but wants to see a substantial increase in rental income from the property?

The short answer, of course, is "tough". Such an answer will not be satisfactory to some, however, who may be quite happy to try to use the provisions of the RTA in less than good faith in order to clear out the existing tenants and move new tenants in to the property at a substantially increased rent. This creates a potential danger for a seller who is co-operating with a buyer by giving the applicable notice under subsection 49(1) so as to be able to deliver vacant possession on closing.

The first thing to note here is the relief available to an aggrieved former tenant who is alleging a bad faith notice. A former tenant may make an application to the Landlord and Tenant Board (the "Board") under Section 57 of the RTA and the Board can make an order if it determines that a landlord gave a notice of termination under either Section 48 or 49 in bad faith, that the tenant vacated the unit as a result of the notice, and that none of the persons listed in subsection 48(1) or 49(1) who require the unit for residential occupancy subsequently moves in to the unit within a reasonable period of time. In such event, the Board can make an order for compensation for all or any portion of any additional rent which the former tenant has incurred or will incur in new premises plus reasonable out-of-pocket moving, storage and like expenses. The Board can also make an order for an administrative fine of up to $25,000.00 and any other order it deems appropriate. The application must be brought within one year after the former tenant vacated the unit.

So who is at risk? If there has been no change in landlord, the answer is obvious. But what if the notice is given pursuant to subsection 49(1) where there is a seller landlord and a purchaser who are involved?

The case of Tenants v. Quan is a 2006 decision of the Ontario Rental Housing Tribunal (the "ORHT") under the former statute, the *Tenant Protection Act* (Ontario) (the "TPA"). The wording of the relevant provision of the TPA is not materially different from the present statute, however, so I believe that decisions under the former statute are still instructive. The facts are straightforward. Mr. Quan was a landlord of certain tenants, he entered into an agreement of purchase and sale in respect of the property, and at the request of the purchaser he served the tenants with a notice to terminate the tenancy as the property was required for the purchaser's own use. While the termination was to take effect on the closing date of January 31, 2005 it appears that the tenants were still in occupancy at closing. The ORHT decision indicates that the tenants vacated the premises on February 28, 2005. After the premises were vacated, the purchaser undertook some renovations to the property, which was then re-listed and sold.

An initial order was made against Mr. Quan on the basis that it was he, not the purchaser, who initiated the termination procedure. Mr. Quan sought review of the order. In the subsequent decision, the ORHT determined that if the purchaser does not occupy the unit within a reasonable time and it is later found that the notice was given in bad faith, the tenant's claim for compensation is against the purchaser, not the former landlord. The ORHT decision also states that there is nothing in the statute which requires the seller/landlord to ensure that a purchaser genuinely intends to occupy a rental unit prior to serving notice on a tenant. Accordingly, an order for compensation was made solely against the purchaser. Crucial to this outcome, however, was the ORHT's determination that the purchaser was a "landlord" within the meaning of the statute. The TPA's definition of "landlord" (which is essentially unchanged in the RTA) includes in the definition "successors in title" to a landlord. As the tenants were still tenants of the property at closing, the purchaser became the landlord. The

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selling landlord was off the hook.

On the other hand, the 2003 case of Edward Macko and Mary Wasik is a cautionary tale for selling landlords giving notice under subsection 49(1). Mr. Macko had been a tenant at the same property for 19 years. In or about June, 2002 Mr. Macko received a notice of termination of his tenancy as the property had been sold and the purchaser required it for the purchaser's own use. The closing date was August 26, 2002 and the notice of termination was effective as of August 31, 2002. Although Mr. Macko was entitled to stay until the end of August, 2002, he elected to terminate his tenancy early by notice under the provision that is now subsection 49(4) of the RTA. Mr. Macko's tenancy ended on August 8, 2002. The purchase and sale transaction closed as scheduled but the purchaser never moved in to the property and instead re-let the property for a rent which was fifty per cent higher than the rent paid by Mr. Macko at the time his tenancy ended.

In its decision, the ORHT notes that the landlord, Mrs. Wasik, made no inquiries as to whether the purchaser truly intended to live in the unit. The ORHT also noted that both vendor and purchaser had the same real estate agent and there was a vendor take-back mortgage. However, Mrs. Wasik's evidence that she did not know the purchaser's true intentions was accepted. She was duped by the purchaser and, perhaps, her own agent.

The ORHT went on to determine that this did not absolve Mrs. Wasik of liability. I think that it was crucial to the outcome that Mr. Macko's tenancy had ended prior to closing so that the purchaser could not be found to be a "landlord" under the statute and so was not liable to an order for compensation or an administrative fine. The decision states that "[t]o relieve the landlord/vendor of liability in these circumstances would be to acknowledge a gaping hole in the protection the legislation is meant to provide." The decision also states that this outcome does not necessarily make the selling landlord ultimately liable. The ORHT Member states: "In a prospective proceeding before the courts, I expect the vendor would recover against the purchaser. But in the first instance, the tenant should be able to proceed before the tribunal and recover against his former landlord." The Member goes on to state later that "[p]erhaps some sort of warranty that survives closing should be obtained from the purchaser to the effect that the purchaser shall save harmless the vendor from the consequences of applications such as this. There may be other approaches. The real estate bar will figure something out." There was no discussion as to whether Mrs. Wasik may also have had a cause of action against her agent.

So what can we take from all of this? In terms of what to do when a rental property is being sold to a purchaser who requires the property for the purchaser's own use, the safest course is obviously for a vendor is to leave it to the purchaser to exercise a right of termination after closing under subsection 48(1). However, a notice under subsection 49(1) will often be necessary to facilitate a transaction, and if the purchaser asks for such a notice to be delivered on the purchaser's behalf, the selling landlord should obtain a warranty from the purchaser confirming that the proper conditions for termination pursuant to subsection 49(1) exist coupled with a covenant to indemnify in the event the termination is subsequently determined to be improper. While the Quan decision does provide some reassurance for landlords, the fact that a tenant can always exercise an early termination right under subsection 49(4) so that there may be no successor liability (and the time lines may be such that there will be no successor liability in any event) makes such a warranty and indemnity essential. The obvious problem is that these transactions often come to us after the agreement has been signed, conditions waived, and perhaps even the applicable notice delivered. In those circumstances, the warranty would have to be obtained as part of the closing documents and may be resisted if it is not expressly contemplated by the wording of the agreement of purchase and sale.

I also think that some information should be given to purchasers who indicate that they will be renting a property rather than using it themselves. While there are plenty of helpful online guides available for residential landlords, none of the ones that I have reviewed over time talk expressly about what a selling landlord should seek in an agreement with a purchaser in the event the landlord is selling the property and delivery of a notice of termination is requested by the purchaser. And I believe that we can never stress often enough the importance of having an agreement of purchase and sale reviewed prior to being finalized. ■

Brian Hurren practices at Inch Hammond Professional Corporation. He can be reached at: 905-525-4481