



RealEstateBrief

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Property insurance is an increasingly important, yet complex, area impacting on all types of property ownership, use and financing. In our first article, Mark A. Richardson provides an overview of this area. The title search is a fundamental activity undertaken as part of any property acquisition or financing. However, there are a number of off-title searches that are relevant as well. In our second article Bronwyn Atkinson looks at these various off-title searches.

We also provide you with a sample posting from our blog, lawoftheland.blogs.com.

Property Insurance – A Primer

Introduction

All persons having an interest in real estate containing a building or other improvement, whether as owner (landlord), tenant, manager or lender, need to be concerned about property insurance. There are few contracts involving property (whether leases, purchase agreements, property management agreements or otherwise) that do not have insurance provisions. These contracts often use insurance industry terms that may not be familiar to most people. The purpose of this article is to describe the types of property insurance and certain information about property insurance, including important but infrequently used options and amendments that are available. Hopefully this will assist the reader in reviewing insurance requirements and making better and more informed decisions about the appropriate insurance in each case.

A. Perils Insured Against

The most important distinction between the different forms of property policies is derived from the perils insured against and results in three basic types of property policies.

1. Fire Policy

The fire policy insures only against loss from the perils of fire, lightning and explosion of natural, coal and manufactured gas. The fire policy is the original property policy. Because of its limited coverage, it is rarely used today.

2. Fire and Extended Coverage Policy

The Fire & E.C. (“Fire & E.C.”) policy extends the coverage of the fire policy to include certain additional risks including:

- smoke;
- impact by aircraft or land vehicles;
- riot;
- vandalism or malicious act;

- sprinkler leakage; and
- windstorm or hail.

If a building is not classified as a preferred risk, there is no coverage for vandalism and malicious acts causing damage; however, vandalism and malicious damage can be covered by specific endorsement.

Some policies may expand the coverage. For example, the coverage of Factory Mutual insures against the following additional perils:

- acts of destruction by civil authority to prevent the spread of fire;
- accidental discharge, leakage, back-up or overflow of liquids originating on the premises;
- heat from molten material accidentally escaped from equipment;
- radioactive contamination from materials or processes conducted on the premises; and
- volcanic eruption.

Coverage of these additional perils may be important, especially having regard to operations that may be conducted on the premises.

The coverage under a Fire & E.C. policy is subject to a number of exclusions, such as war and related activities, changes in by-laws preventing repair to pre-loss condition and loss caused by vehicles belonging to or under the control of the insured. Many exclusions may be deleted, often without extra cost. Other exclusions may be covered by other insurance, for example, the exclusion of explosion of pressure vessels owned, operated or controlled by the insured may be covered by boiler and machinery insurance and the exclusion of loss due to theft may be covered by crime coverage.

3. All-Risk Policy

The all-risk policy insures against all property loss perils, subject to exclusions, and generally provides broader coverage

than the Fire & E.C. policy. The perils that are excluded under different policies will differ depending upon the insurance company and on the activities carried on by the insured. The following are some examples of exclusions:

- earthquake, snowslide, landslide, subsidence and flooding by the overflow of any body of water, except for ensuing loss or damage which results from fire, explosion, smoke or leakage from fire protection equipment;
- smoke from industrial operations;
- wear and tear; and
- the cost of making good faulty or improper material or workmanship.

Certain exclusions may be covered by another policy specifically designed for the peril, for example, employee theft and explosion of pressure vessels.

B. Type of Property Insured

Coverage under a property policy generally includes building, equipment, stock (product intended for sale) and contents. Coverage of any type of property is optional, so that, for example, an insured who owns a number of buildings could limit coverage to buildings only at one location and equipment and stock only at another location (where the insured may be a tenant in a building that the landlord carries insurance on).

The property covered is subject to exclusions, including the following:

- money, bullion, securities, evidence of debt or title;
- watercraft (except stock held for sale);
- licensed vehicles; and
- aircraft.

Other types of policies offer coverage of these types of property.

There is an exclusion for property at locations that, to the knowledge of the insured, are vacant, unoccupied or shut

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down for more than 30 consecutive days. An endorsement permitting vacancy may be available.

It is important to note that most all-risk policies exclude more types of property than are excluded by the standard Fire & E.C. policy. Many of the additional exclusions may be deleted and, in some cases, at no additional premium cost. Examples of additional property exclusions in all-risk policies include sewers, drains or watermains located beyond the outside walls or foundations of the property insured, plants (except for decorative purposes within buildings), animals, fur garments and jewellery.

C. Basis of Settlement

In the event of an insured loss, the basis of settlement in the policy is an important factor governing the amount recoverable.

1. Actual Cash Value

Actual cash value is the purchase price less physical depreciation plus market appreciation, or in other words, the price at which property of the same type, age and condition can be purchased. This basis of recovery is not suitable where such property is not available for purchase.

2. Replacement Cost

Replacement cost means the amount of the recovery should be adequate to replace the property with new property of the same type and quality. Usually, if there is no replacement or if replacement is not carried out with due diligence and dispatch, the basis of settlement will revert to actual cash value. Also, often replacement must be on the same site or an adjacent site, which may cause hardship if there have been changes in building restrictions preventing construction of the same or similar buildings. This same-site condition may be deleted.

3. Valued Amount

In this case, the value of the property is set out in the policy as the amount to be paid in the event of a total loss. This method eliminates the need to determine value at the time of

loss. Property such as antiques and works of art is often insured on this basis. In the event of a partial loss, the loss as a percentage of the valued amount must be established.

4. Selling Price

The selling price basis of settlement applies to finished product intended for sale. Recovery is based on the selling price at the time of loss and therefore includes profit on potential sales.

D. Policy Limits

1. Scheduled Limits and Blanket Limit

Separate limits, referred to as scheduled limits, may be established for each building, piece of equipment or other property insured. Separate limits may be set for the total value of equipment or stock in a building, a building including its contents or for each location (regardless of the number of buildings at the location).

As an alternative, a blanket limit may be used for all property insured by the policy. The limits are normally set at a level that represents either the total value of the property at the location of highest value ("limit of loss limit") or the total value of all property insured by the policy ("100% blanket limit"), which provides full protection.

Scheduled and blanket limits may be combined in the same policy for different classes or groups of property.

2. Co-Insurance

If an insured is comfortable that any loss to its property will only be from partial damage, it could attempt to reduce its costs by underinsuring. For example, the insured could take out \$500,000 of coverage on a \$1,000,000 building, taking the risk that any damage would not exceed the covered amount. The co-insurance clause is the insurance industry's response to this and requires the insured to maintain an amount of insurance equal to or greater than a stipulated percentage of the value of the insured property at the time of

There are many specialized policies for property and perils not covered by standard policies without special amendment and which offer policy conditions different from those in standard policies. Such policies give an insured increased coverage and greater flexibility in structuring property insurance.

loss. If the percentage is not maintained, the policy will not pay the full amount of the loss (whether the loss is within the policy limit or not), but rather recovery will be a proportion of the loss in the ratio that the insurance obtained bears to the minimum amount of insurance required by the policy. In the above example, if the co-insurance clause required the insured to insure for the full value, in the event of \$500,000 of damage, the insured would only recover \$250,000 as the insured only insured for half of the value.

If the value of the property insured increases after the insurance is placed, the amount of insurance may have to be increased to maintain the required percentage.

The risk of not maintaining insurance equal to the required percentage of value may be eliminated by adding a stated amount clause in the policy, which fixes the required amount of insurance. There is usually no additional cost for this addition.

E. Specialized Policies

There are many specialized policies for property and perils not covered by standard policies without special amendment and which offer policy conditions different from those in standard policies. Such policies give an insured increased coverage and greater flexibility in structuring property insurance. Examples of specialized policies are as follows:

- office contents;
- fine arts floater;
- valuable papers;
- electronic data processing;
- transit (covering property while being transported);
- builders' risk to cover construction activities;
- exhibition floater (covering property at trade shows or exhibitions); and
- contractors' equipment.

Conclusion

Property insurance is technical and complex. We recommend that insurance should be placed in consultation with knowledgeable professional insurance advisors who will advise you on the types of insurance and options available to you. It is important to make sure you fully understand what property is covered by your insurance and to what extent.



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Real Estate Searches Beyond the Title Register

Title vs. Off-Title Searches

When purchasing or financing a property, various searches must be undertaken to confirm that the vendor or, in the case of a financing, the owner has good title to the property and that the property is marketable. These searches are divided into two basic groups: title searches and what are referred to commonly as “off-title” or “letter enquiry” searches.

Title Searches

A title search confirms the registered owner and legal description of the property and whether any encumbrances (i.e., mortgages, agreements or restrictions) are registered against title to the property. In Ontario, a transfer that does not comply with the *Planning Act* approval process to subdivide property is void,

and a title search will determine if any past contraventions of the provisions of the *Planning Act* relating to this process affect title and whether the property can be transferred or mortgaged without violating these provisions. In addition, the title search will confirm if there is legal access from the property to an original road allowance or another recognized public road.

Writs of execution (judgments) against an owner of property constitute a lien against the property. An additional component of the title search is an execution search to determine if there are any such writs. Although an execution search is sometimes classified as an off-title search, it is performed at the registry office or, more commonly (in Ontario), through Teraview, the electronic gateway into the land registration system, and is more accurately deemed to be part of the title search process.

Off-Title Searches

While the title search will reveal issues that are reflected on the property register for the property and the lands adjoining the property, the title and marketability of the property may also be affected by matters that are not reflected on the property register. Various federal and provincial statutes and regulations and municipal by-laws impose liens against title to property and restrictions governing its use. Off-title searches are undertaken to determine whether there are any such liens or restrictions and to determine whether the property complies with any applicable statutory requirements and municipal by-laws. These off-title enquires are in addition to (and not in substitution for) the physical inspections and other due diligence that a purchaser or lender will want to conduct in respect of matters such as environmental contamination, the state of the building structure and the state of the building's mechanical, electrical and other systems.

Off-title searches are often referred to as "letter enquiries" because the searches were conducted traditionally by sending a letter to the applicable body requesting the relevant information and/or confirmation that the property was in compliance with the applicable legislation, regulation or by-law. The time it takes the various government bodies and organizations to respond to such enquiries varies significantly. Some responses will be received in days, others take weeks or even months. However, many of these searches may (and, in certain cases, must) now be undertaken online or, at least, must be in a form made available online, which is intended to speed the process up by standardizing the requests.

Scope and Cost

There are dozens of off-title searches which may be conducted in any circumstance. The fees associated range from zero (very infrequently) to hundreds of dollars. This becomes quite costly in circumstances involving multiple properties, as fees for searches may be on a per-property basis.

The scope of searches undertaken in a particular transaction will depend on the nature and location of the property in question. Different statutes, regulations and by-laws may and do apply to residential and commercial properties, to urban and rural properties, and to farm and cottage properties. Any information as to the history of the property will also be relevant in establishing the extent of the off-title searches; for example, if the property was or is used for purposes that pose environmental risks, environmental searches should be more extensive than they would otherwise be.

The scope of the searches carried out will also be limited by the nature and size of the transaction. This will be defined

by the risk the parties to the transaction are willing/required to assume versus the cost the purchaser/owner is willing to bear. Accordingly, a large commercial transaction that includes a financing will result in a greater number of searches being undertaken as there will be more at stake financially, and accordingly the parties (both purchaser and lender) will desire greater certainty as to the viability of the property.

Common Off-Title Searches

Although the scope of the off-title searches undertaken in any transaction will be defined by the particular circumstances, there are a number of common searches that are almost

always conducted. These searches reveal matters that go to the root of title, which reveal fees or charges that have or potentially can have priority lien status against the property or which most commonly affect the use that may be made of the property. These include:

- a) *Realty Tax Arrears*. Pursuant to the provisions of the *Municipal Act, 2001* (the "Act"), realty taxes form a special lien on the property in priority to every claim, or encumbrances of every person or entity except the Crown. Accordingly, arrears of realty taxes take priority over anything else registered on title (even if the tax arrears arise after the mortgage or other registered interest). Change of ownership does not remedy realty tax

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arrears. To determine whether there are any arrears of realty taxes, a tax certificate is obtained from the local municipality.

- b) *Local Improvement Charges.* The Act also provides that fees and costs for local improvements may be added to the tax roll and collected in the same manner as realty taxes and have the same special priority lien. Accordingly, the request for a tax certificate should also enquire as to these items.
- c) *Public Utility Charges.* Fees and charges imposed by a municipality for public utilities fall under the same rubric as local improvement charges and, accordingly, a similar enquiry must be made as to the existence of outstanding public utility charges when the request for the tax certificate is made. Private utility companies do not get this benefit.
- d) *Building Department – Zoning Compliance and Municipal Work Orders.* A zoning enquiry to the building department of the applicable municipality will seek information on whether the existing use can be lawfully continued and whether the property is in compliance with the by-law standards. In addition, the building department response will reveal whether there are any outstanding permits, inspection files or work orders. If work required under a work order is not completed within the prescribed time period, the municipality may complete the work and will have a lien on the property for the cost of same, which will be added to the tax roll and have priority lien status in accordance with the provisions of the Act.
- e) *Electrical Safety Authority.* The ESA may issue orders relating to any electrical work that is deficient or improperly completed. A request should be made to the ESA confirming that there are no such work orders outstanding.

If work required under a work order is not completed within the prescribed time period, the municipality may complete the work and will have a lien on the property for the cost of same, which will be added to the tax roll and have priority lien status in accordance with the provisions of the Act.

- f) *Unregistered Hydro Easements.* Generally, hydro easements are registered on title. However, an unregistered right to such easement may be claimed under the *Electricity Act, 1998* or the repealed *Power Corporation Act*. Requests for confirmation as to the existence of such easements may be made to Hydro One or the applicable municipal hydro corporation.

Some off-title searches will arise from a review of the title search. Federal and provincial legislation provides that, upon the dissolution of a corporation, any property owned by the dissolved corporation escheats (i.e., is forfeited) to the Crown. This constitutes a break in the chain of title and accordingly

any subsequent transfers of the property would be void. Title to the property must be searched to determine whether title to the property was held by any corporate owners and then a corporate search of each corporation that held title must be undertaken to confirm that it was in existence during its period of ownership.

The title search will indicate if there are any municipal agreements registered on title. If so, an enquiry should be sent to the responsible department requesting confirmation of compliance with all terms of each such agreement. Any such agreements may be enforced against subsequent owners of the property, and certain monies payable under such agreements have priority lien status.

As noted, these only represent the searches that are most commonly conducted. The extent of the additional searches conducted will, as discussed above, be defined by the circumstances.

Title Insurance

One of the most frequently cited benefits of title insurance is that it reduces the need for off-title searches. Title insurance companies provide extensive (and often somewhat inscrutable) lists of their search requirements and coverages and have decided, in certain situations, to take the risk of not conducting certain enquiries. The rationale behind this is that

the risk that anything will be discovered by the enquiry is remote and not worth the cost of making the enquiry.

The exact requirements of the title insurer vary depending on the nature and size of the transaction, the scope of coverage required and whether a purchaser's or borrower's policy is being requested. In all cases, prior to issuing a commitment, a title insurer will generally require at least confirmation that a title search (including an execution search) has been prepared and that a tax certificate has been obtained showing no arrears of taxes or other charges. Other searches may be required depending on the facts.

Although title insurance does obviate the need for certain searches, policy exceptions should always be reviewed to determine what is not covered by the policy in question and, if an enquiry or an endorsement could address the exception, it should be considered. Further, depending on the nature of

the transaction, regardless of whether an enquiry is not required for title insurance purposes, in some circumstances it should be conducted for due diligence purposes.

Title insurance companies provide extensive (and often somewhat inscrutable) lists of their search requirements and coverages and have decided, in certain situations, to take the risk of not conducting certain enquiries.

Consider the Facts

The extent of the off-title searches undertaken in any transaction will depend on a number of factors, including the nature of the property, the size of the transaction, and whether the transaction is being title insured. Knowledge of the history and present status of the property and the intended use of the property will be determinative.



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Law of the Land – Canadian Commercial Real Estate Blog

We invite you to the Lang Michener LLP Real Estate Group's Blog at lawoftheland.blogs.com. Here is a recent sample of a posting on this site.

Fixed CAM/Gross Leases – An Emerging Trend?

Typically in Canada commercial leases are net leases. Under a net lease, the landlord receives a basic or minimum rent together with payments from the tenants of their share or allocation of maintenance and operating expenses, property taxes and utilities.

There appears to be a trend emerging from shopping centres in the United States to move towards fixed common area charges. Instead of landlords passing through the actual variable common area maintenance charges ("CAM"), the landlord and tenant agree to a fixed CAM charge.

We may see this trend make inroads into Canada, especially as more US retailers enter the market.

History

In some ways, the trend to a flat CAM is a reversion back to a previous practice. Historically leases were commonly "gross" leases where tenants paid a rental amount and nothing further. The trend to net leases appeared in the late 60's and early 70's and seems to have been caused by the construction of shopping centres with interior malls. Operating costs for interior malls are substantially more than malls without an interior and landlords reacted by passing on those increased costs. Other types of leases followed suit.

In 2001, one of the major US shopping centre landlords abandoned variable CAM charges and moved to a fixed CAM. Recently two other major US landlords have followed suit to some degree, such as by offering tenants a choice of a fixed CAM or a variable CAM.

Benefits of Fixed CAM

The following have been seen as benefits to moving to a fixed CAM:

1. Lease audits (by tenants and by third parties working for contingency fees) have become more common and require landlords to devote a considerable amount of resources to respond. Fixed CAM eliminates this;
2. Negotiating the operating costs provisions of the leases tends to be one of the most time consuming components of a lease negotiation and it is thought that such negotiations could be made more efficient with a fixed CAM;
3. Tenants get certainty from a fixed CAM; and
4. Fixed CAM is seen as imposing more discipline on shopping centre managers to keep costs down.

Risks of Fixed CAM

Obviously the main risk of a fixed CAM to the landlord is that it passes the risk of change to the landlord and away from the tenant. This is mitigated to some degree by the trend in retail leasing to move to five year leases (while 20 to 30 years ago it was not uncommon to see 20 year leases). Landlords will also obviously build in a cushion which pushes the risk to some degree back to tenants and often the fixed CAM is subject to fixed increases each year.

Another way that landlords will mitigate this risk is to delete certain items from the fixed CAM (and keep such costs as variable). For example, realty taxes are generally outside of fixed CAM charges and charged separately. Utilities, snow removal and insurance are other costs that are often seen as non-controllable by landlords and may be pushed outside the fixed CAM.

From a tenant's perspective, there is of course the risk that it will pay too much on account of fixed CAM (that is, agree to a number well in excess of the actual cost). Some have suggested that the tenant needs to do an audit or otherwise get comfortable with the landlord's costs before agreeing to the number. Another potential risk seen by tenants is that landlords may reduce the level of management and operation as costs increase, resulting in a less attractive centre.

Conclusion

The trend towards fixed CAM seems to be picking up speed in the United States. Whether it makes the jump into Canada and, if so, at what point and to what degree, remains to be seen.



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