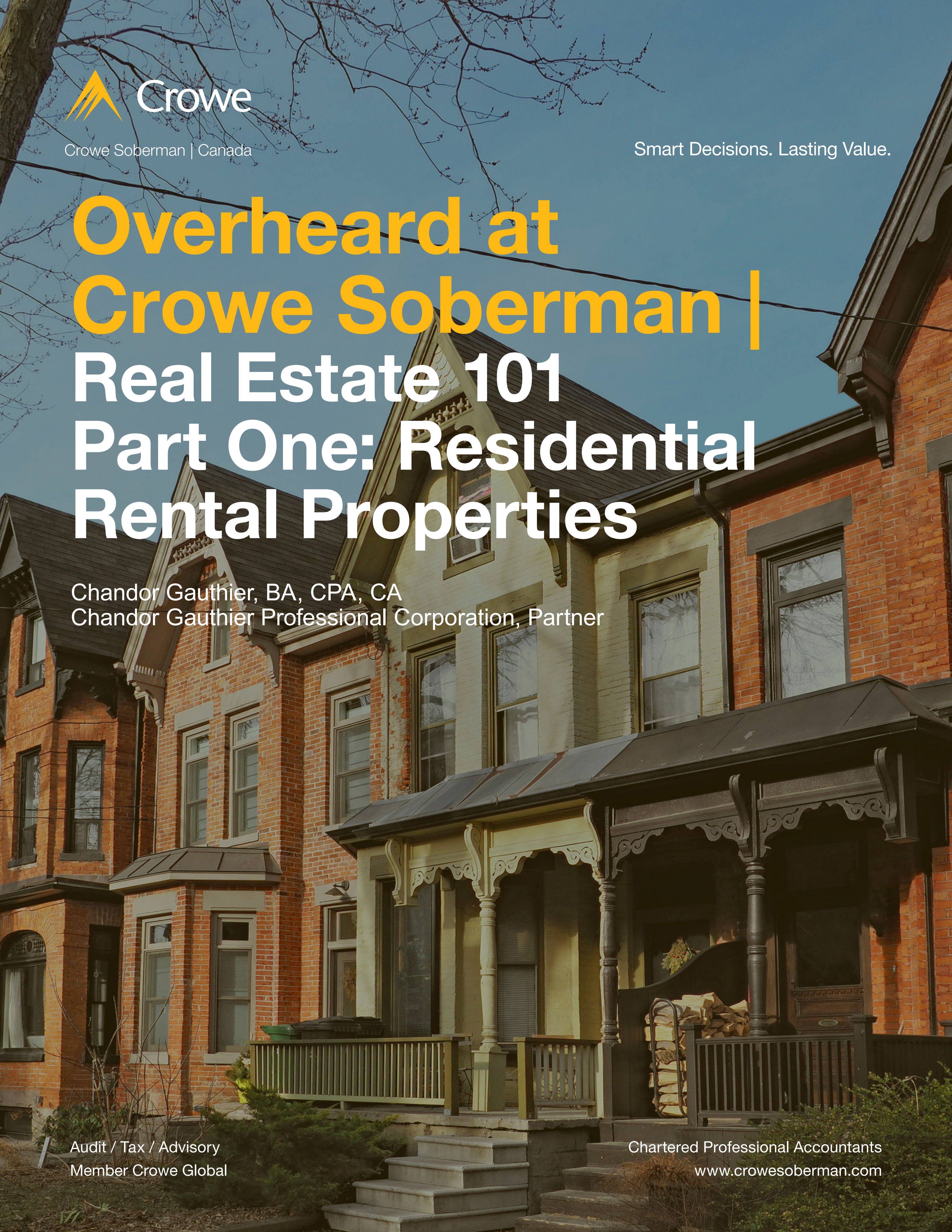

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Overheard at Crowe Soberman | Real Estate 101 Part One: Residential Rental Properties

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overheard

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It's no surprise that residential rental markets across Canada, especially in Ontario, are red hot. The demand for rental units is overwhelming with **renters accounting for over 30 per cent of Canadian households**. For those fortunate enough to have investment capital, becoming a landlord has become a lucrative investment opportunity.

We sat down with Audit & Advisory Partner and **Real Estate & Construction** industry expert, **Chandor Gauthier**, to discuss how residential rental landlords can proactively plan and ultimately save money, rather than trying to fix issues after they arise.

What are the different ways to own property?

When you are buying real estate, there are a few different ways you can own it:

- Personally
- Through a trust
- Through a corporation
- Through a partnership
- Through a joint venture or co-tenancy arrangement

Each of the structures comes with its own advantages and disadvantages. It's important to talk with your advisor to understand which structure works best for you, based on your short-term and long-term goals. For example, your short-term goal could be to rent it out but long-term you will want to live in it. Or your goal could be to rent it out for a few years before selling and using the funds for another investment. It's essential to consult with a professional to help you make the right decision before you purchase the property. Fixing things after the fact can be much more costly than getting it right the first time around.

How can I finance a rental property?

Once you've decided that you're going to purchase a property, you need to figure out where the money is going to come from. This could be existing personal funds, a mortgage or other types of bank financing, or bringing in a partner. How you plan to finance the purchase may play a role in your structuring decision, and vice versa. Consider what the bank or outside lenders are going to request as security. The property itself might not be sufficient, especially if you don't have a history of property purchases or other personal security. Also, if you plan to hold for only a few years, you will want to consider how flexible the repayment terms are.

Do I need insurance?

Liability coverage insures you if you're responsible for damage or injury to a person or their property. For instance, if the property is located where there tends to be severe weather, consider insurance that will cover possibilities like a slip and fall. If a tenant is injured this way, liability coverage would protect you in the case of a lawsuit. Property coverage can insure the building, building upgrades, equipment, etc. Severe weather can be a concern for a slip and fall but also damage to your property. Ensuring you have adequate insurance coverage is essential. Talk with your insurance provider about how much and what types of insurance you should consider.

What about leases, rent increases and special provisions?

As a landlord, you want to follow the laws and regulations in your jurisdiction. Consider items such as legally enforceable lease clauses, permitted annual rent increases, etc. In Ontario, the **Landlord and Tenant Board** (LTB) acts as the regulatory body that provides information to landlords and tenants about their rights and responsibilities under the **Residential Tenancies Act**. In some instances you may be able to increase rent beyond the guideline amount. For example, where there are improvements to the rental unit or the property itself. Consult with the LTB about whether a rent increase above the guideline amount is permitted in your situation and to ensure you complete any necessary documents. For lease and property purchase agreements, we recommend consulting with a lawyer.

Where can landlords get help when there is a tenant dispute?

There is a possibility that you're going to have unhappy tenants at some point – either with the rent they're paying or something that's happening in the unit. The tenant might withhold rent as a result of their frustration with the situation. You have to be careful as a landlord. The solution is not as simple as evicting the tenant. Though you might not need to talk to a lawyer right away, it is something to consider.

One of the mandates of the **LTB** is to resolve disputes between landlords and tenants through mediation or adjudication. The LTB has resources available to landlords which will help determine what to do in case of a dispute.

What is considered a capital item?

As a landlord, some of your major cash outflows are going to be for repairs and maintenance. As these costs are incurred, consider whether it is a repair/replacement or a betterment. Is it going to extend the life of your property? Is it a separate asset? A new fridge or stove, for example, is a separate capital item. A fresh coat of paint would fall under repairs and maintenance. Your accounting professional will be able to provide guidance as to whether an amount is a capital item or an expense.

Which expenses are deductible?

First of all, consider using a separate bank account and credit card to ensure all cash inflows and outflows can be tracked accurately. Costs like painting, plumbing repairs, and new appliances are likely already on your radar. Another expense to consider is depreciation. You are allowed to take a portion of the cost of capital items (like the rental building and appliances) into your expenses over time as depreciation to the extent that you have rental income.

What about the use of your personal vehicle to drive to the property to supervise work or meet with the tenant? Or costs related to the purchase and financing – legal fees, financing costs, and ongoing interest payments? For example, let's say you set up a new company to purchase the property but obtain personal financing. You put the cash into the company for the property purchase. You likely paid financing fees personally to the bank and will pay interest on that financing from your personal bank account. You want to ensure these cash outflows are captured in the company and reimbursed to you personally. Talk to your accounting professional to make sure that all cash outflows are being captured.

What if you purchased a house and decided to live in the second floor unit and rent out the ground floor unit? In cases like this, you want to be careful with tracking and allocating expenses between the two units. Some expenses will relate to the property as a whole like landscaping, snow clearing, property taxes, and utilities (if not separately metered). Other expenses are unit specific like cable and internet or plumbing repairs for only one of the units. Amounts related to the personal second floor unit would not be deductible as an expense on the rental unit and you will need to consider a reasonable allocation for expenses that relate to the whole property.

You'll also want to have an idea of your cash outflows going forward (i.e.: make a budget and don't forget about principal repayments on financing). This will help you figure out if the rent you will be charging will offset all those outflows and still leave cash in your pocket.

I want to move into my rental property or convert my home to a rental property. Now what?

Let's say the residential property you purchased is rented out for a few years and then you decide you want to live in it. Or you currently live in a property and want to move out and rent it out. Either of these could result in a change in use, which means CRA could consider you to have disposed of the property even though you continue to own it and there could be tax to pay.

You may be able to prepare and file an election which will defer the change in use but there are time limitations to do this. Deferring the change in use delays reporting as taxable income the increase in value on the property. This option is not available if you have claimed depreciation on the property.

How does the Principal Residence Exemption impact my rental property?

The principal residence exemption (PRE) allows a portion or all of the increase in value on a property to be tax free. You can designate one property per year of ownership and you or a family member must have occupied the property at any time in that calendar year. If you are planning on claiming a property as your principal residence which includes a unit you live in and a rental unit, the **PRE may be affected**.

As always, it's important that you discuss options with your professional advisor in order maximize tax savings, engage in proactive tax planning, and protect your wealth.

Specific professional advice should be obtained prior to the implementation of any suggestion contained in this article. Contact your Crowe Soberman advisor for more information.

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A reputation for warmth and good humour with a proven track record advising clients on strategic decisions, how to develop and grow their business, and how to maximize their family wealth. Chandor holds an extraordinary blend of strong technical expertise with a flair for collaborating with a wide range of clients and their team of external advisors. Connect with Chandor via email at chandor.gauthier@crowesoberman.com or call 416 963 7220.

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Based in Toronto, Crowe Soberman is one of the leading public accounting firms in Canada. The firm has been in business over 60 years and has built a strong reputation in the community because of the excellent work our teams of dedicated professionals produce.

Our core services are in Audit, Tax, and Advisory. Along with these, we have professionals who specialize in Business Valuation, Claims Valuation, Corporate Recovery & Turnaround, Forensics, Estates & Trusts, Global Mobility Services, HR Consulting, Commodity Tax (HST), International Transactions & Consulting, International Tax, Litigation Support, M&A Transactions, Management Services, Personal Insolvency and Succession Planning. Members of our various specialty services groups are available when required as a technical resource to assist the client service team.

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