The real cost of buying a multi-residential property

Christopher Seepe examines the closing costs for buying a multi-residential property in Toronto

If you have not purchased a multi-residential property before, especially in Toronto and especially if the number of units is greater than six, you may be surprised by the myriad of costs involved.

In southern Ontario, traditional lenders generally consider a four-plex or smaller to be a *residential* transaction, while six or more units in a property is considered to be a *commercial* transaction, the latter usually bearing more expenses.

Here is a list of some of the types of closing costs you could expect to pay. The prices are approximate and will vary wherever you are. This list is for a purchase of an 11-unit apartment building in a city outside Toronto (hence no Toronto Land Transfer Tax). The zero-dollar values are costs that might arise, depending on the deal structure and financing.

Note 1: Land Transfer Tax – incorporate a company

Land transfer tax is a significant expense and is triggered whenever there is a change in title ownership at the Land Registry Office (LRO). An additional land transfer tax is also triggered if the real estate transaction occurs in Toronto.

If you incorporate a company and the company's only asset is the property, when you decide to sell it, you can sell the *company* with all its assets (and liabilities), not the property itself. Since title ownership is still held by the company, no land transfer tax is triggered. This can be a notable advantage to the buyer, which the seller can leverage in its negotiations.

Note 2: CMHC Insurance – do it but be aware of the 'money-grab'

Canada Housing and Mortgage (CMHC) offers mortgage insurance to traditional lending institutions to cover the loss if a mortgagor defaults.

THE COST OF BUYING A MULTI-RESIDENTIAL PROPERTY

HST on purchase price	$0
Ontario commercial Land Transfer Tax[1]	$11,775
Toronto commercial Land Transfer Tax[1] (could be an additional $11,000)	$0
CMHC insurance premium[2]	$32,110
CMHC premium PST (8%)[2]	$2,568
1st mortgage prepayment penalty	$0
CMHC credit[2]	-$0
CMHC application fee[2]	$1,650
Insurance consultant[3]	$340
Government registration fees	$0
Survey (no survey usually covered by title insurance)	$0
Incorporation[4] (of numbered Ontario company)	$1,065
Phase I Environmental Assessment[5]	$1,840
Mortgage application	$0
Lender's inspection fee[6]	$250
Lender's legal fees[6]	$4,100
Existing mortgage assumption fee	$0
Mortgage Commission[7]	$6,760
Building Inspection	$750
Legal (your lawyer's fee for the work, not including fees on the Statement of Adjustments, below)	$2,800
Title Insurance[8]	$980
Statement of Adjustments and Legal Disbursements (includes blue values below)	$2,059
• City Tax Certificate	60.00
• Zoning reports	122.00
• Engineering reports	0.00
• Sheriff's certificates (depends on # of names)	56.00
• Registry office searches (depending on the complexity of the purchase and # of documents)	300.00
• Utility searches (depends on # of open accounts)	75.00
• Register deed	72.00
• Register Mortgage	72.00
• Copies/fax/postage/courier	0.00
• Elevators	42.00
• Corporate searches	0.00
• Fire	63.00
• PPSA (Personal Property)	30.00
• Electrical safety	53.00
Mortgage Interest Adjustment (if any)	$0
Mortgage Insurance (if any)	$0
Other	$0
Co-op Brokerage Commission received	$0
Listing Brokerage Commission Paid	$0
HST on Commission	$0
	About $70,000

Lenders generally consider multi-unit financing to be much less risky when it's insured by CMHC so they offer lower interest rates, sometimes 200 basis points (2%) or more. The amount of interest saved over the term of the loan can be more than CMHC's heavy insurance premium. Do the math.

For example, on a $500,000 mortgage, a 2% lower five-year rate would save about $34,000, *after* accounting for CMHC's $11,250 premium and $750 application fee (currently $150 per unit). Moreover, the property enjoys a 16% better cash flow because of the lower mortgage payment.

This is one of those cases where the adages, "*pay to save*" and "*penny-wise, dollar-foolish*" are appropriate.

CMHC's premium varies according to the amount of the deposit applied against the value of the property being purchased (loan-to-value or LTV); the higher the LTV ratio, the higher the premium. CMHC will insure up to 80% LTV. However, CMHC does not use the appraised value of the property as determined by independent appraisers or market comparables. CMHC sends its own appraiser and their appraised property value is very often much lower than the purchase price. This forces the buyer to either:

(a) Put in a higher deposit than was originally planned;

(b) Pay the additional CMHC premium for an 80% LTV that is actually perhaps 70% of the market value LTV.

On a more positive note, the CMHC premium (and certain other expenses) can be rolled into your property's mortgage amount but does not count as part of the LTV ratio calculation. PST (provincial sales tax) on the premium amount is due upon closing and cannot be rolled into the mortgage.

The majority of multi-residential mortgages (excluding perhaps purchases by corporations) are CMHC-insured. Therefore, it is possible that you may come across a multi-residential property for sale that is *already* CMHC-insured, which is a bonus. CMHC's insurance premium is a one-time fee for the life of the mortgage. You may want to explore whether to take over the existing mortgage, with a new CMHC insurance premium but possibly without having to go through another appraisal. Consequently, there may be a CMHC credit.

Note 3: Building Insurance

A lender will sometimes require you to have an independent insurance consultant review your building insurance, which you must have in place before closing, to determine whether you have enough and appropriate insurance for your property.

Insure your building for the replacement value, not the purchase price or appraised value. Otherwise, you could find your investment completely wiped out if your building has been destroyed.

Note 4: Incorporation

There are differing expert opinions on whether or not to incorporate. This is something you have to investigate for your particular situation. I decided to do it for the following reasons:

- Separate legal entity that distances you from personal liability in the event of a claim against you by a tenant or supplier
- Keeps your property and personal finances separate; a big issue with the Canada Revenue Agency
- Land transfer tax benefit (see earlier note)
- Set up an estate trust for your family

- Changing owners of company is easier than changing owners on title
- Pay yourself a *reasonable* salary, on which the company uses its pre-tax profits to pay certain payroll- and benefits-related expenses, and salary deductions (to be written off)
- Certain of your *reasonable* expenses can be written off in the company to reduce your overall taxable income – travel, vehicle operation/maintenance, etc.

This topic is one where a real estate accountant and a real estate lawyer can help you immeasurably.

Note; while you can save money by incorporating a company online by yourself, there are a slew of minutes and other documents that need to be prepared as part of closing the sale of a property. Unless you are intimately familiar with the process, let your real estate lawyer incorporate for you. They will likely have a junior person on staff that does this kind of work all day long and will charge a reasonable fee for the service.

Note 5: Phase I Environmental Assessment

Most commercial loans by traditional lenders in Ontario (plus CMHC) require you to obtain a Phase I Environmental Assessment. Depending on the outcome, a Phase II or (heaven forbid) a Phase III might be required. This is a lengthy topic on its own so you should do some research on this item.

My advice:

- If selling, know what you're getting into before you list the property. You could be setting yourself up for a bucket of grief.
- If buying, make your purchase conditional, at your sole discretion, upon your acceptance of a Phase I report. If there's anything that crops up that you don't like, you have a quick and inexpensive way out of the deal.
- Shop around. I received quotes ranging from $1,500 (plus hidden costs) to $3,480 – for more or less the same service. The lender likely also has an approved supplier list or may require that your chosen vendor passes the lender's qualification process.
- As earlier mentioned, make sure you know *all* the costs; minimize the variable expenses which some Phase I suppliers charge.

Note 6: Lender's Fees

If you don't know it by now, you're in for a rude awakening. Financial lenders don't pay for anything, and charge you for everything. Identify all the fees upfront and don't be afraid to negotiate with the lender for charges that are downright unreasonable or not even warranted.

However, you will almost assuredly have to pay the lender's legal fees, using their lawyer (sometimes they'll let you use your own). And their fees will be substantially higher than yours and you don't have much of an option to negotiate them.

Note 7: Mortgage commission

Mortgage commission can be all over the map but self-respecting, proven mortgage brokers are worth their weight in gold. I find that 1% of the loan amount (excluding rolled-in fees like CMHC premiums) seems to be reasonable.

Like Realtors, there are literally thousands of mortgage brokers, but, also like Realtors, the really good ones are much less common.

Even with a good one, be aware that, while they may have a fiduciary obligation to you, the truth is they will probably work with you once (or perhaps a few times) but they work with lenders' representatives every day. Mortgage brokers do not *shop* your opportunity around. They usually have preferred suppliers and will present you to that small group (perhaps three lenders). Find out who their suppliers are and continue to do your own homework. I found one top-notch mortgage broker that I came to respect highly but I continued to do my own research and actually found a lender that was 150 basis points below the best offer my broker had. Of course, he now also has a new preferred supplier.

Note 8: Title Insurance – you gotta have it

Title insurance has a great many benefits and you should definitely obtain it. In fact, I think just about all real estate lawyers will tell you to do so. The price varies according to the size and type of property. From *First Canadian Title's* website, title insurance benefits include:

- Protects against not being able to sell your property in the future, or not being able to obtain financing against your home, as a result of defects that would have been disclosed on an up-to-date survey, Real Property Report or Location Certificate
- Protection against fraudulently registered mortgages against your title
- Legal fees associated with resolving insured title issues will be covered
- Coverage for renovations completed without a building permit that result in a loss

Protection should a property not meet municipal zoning requirements

- Protection in the case of someone claiming an interest in your land; for example, an easement for a driveway or a builder's lien
- Problem solving/facilitates closings—frequently provides coverage for known defects such as encroachments, delays in registration and zoning violations.

Note 9: Utilities Deposit

As a new account holder, you may also be required to make a deposit with a utility company, which can be notable (e.g. electricity $3,000).

The cost of purchasing a multi-residential property can be substantial, and like most things, can be negotiated. Applying yourself to the research and process can save you thousands of dollars. ■

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