Baker Schneider Ruggiero LLP

Mortgage and Real Property Law Report

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A Legal Newsletter for the Mortgage and Real Estate Industries

The Elements of a Discharge Statement and the Validity of Tender

In another recent decision before the Ontario Court of Appeal, the outcome hinged on whether a lending bank's written statement as to the amount owed by the borrower constituted a "discharge statement," and whether the borrower's informal offer to pay the amount was proper tender, so as to trigger the borrower's right to pay off the loan and obtain a discharge under the *Mortgages Act*.

The borrower had obtained a demand loan for $875,000 from the bank, which was secured by a first-charge collateral mortgage of $1,500,000, along with a general security agreement and a general assignment of rents. The loan agreement and the mortgage also provided that the borrower would pay the reasonable fees of the bank in enforcing its rights under those documents. The costs were to form a charge against the property and would be secured by the mortgage; the borrower could not have the mortgage discharged until after the monies secured by the mortgage had been paid.

The bank later demanded repayment of the $875,000 under the loan agreement (*i.e.* not under the mortgage), and it negotiated with the borrower's lawyer for an agreed repayment period and a forbearance agreement. Prompted by a request by the borrower for a "discharge statement for information purposes," the bank provided a written statement as to the amount outstanding, consisting of a statement showing only the principal and interest. There was no mention of legal costs, and no heading or other indication on the document that it was a "discharge statement" in the usual form. Furthermore, no formal demand under the mortgage was ever made by the bank.

After receiving the bank's statement, the borrower's lawyer sent the bank a letter offering to pay the amount owing, provided the bank would sign a Document Registration Agreement that the borrower had prepared. The issue arose whether the borrower's offer was valid tender, and whether the provisions of the *Mortgages Act* were triggered. The borrower accordingly applied to the court for an order compelling the bank to discharge the mortgage and the other security provided by the borrower, provided the borrower paid approximately $800,000 (representing the amount demanded and remaining after two payments to the bank had been deducted).

In bringing its action, the borrower relied on ss. 42 and 43 of the *Mortgages Act*, claiming that the so-called statement from the bank amounted to a "discharge statement" for the purposes of s. 43 (which obliges a person who has made a demand to accept the payment of the demanded amount, as long as the payment is made as stipulated by the demand). The borrower also claimed that the bank could not require the payment of the disputed legal costs as a condition of discharging the mortgage.

In these circumstances, the court found that s. 43(1) of the Mortgages Act did not come into play at all, since there was a demand for payment under the loan agreement, but no demand under the mortgage, and nothing to indicate that the lender was commencing a power of sale proceeding. Indeed, there had not been a default under the mortgage at all.

Also, the letter from the borrower's lawyer purporting to be valid tender of the full amount of the loan with interest was defective, because it was not an unconditional offer to pay. Also, proper tender required the payment of both principal and interest that was owed as of that day, together with the legal costs that the bank demanded. So in addition to there being no default under the mortgage, there was no legally-valid repayment offer which would stop the running of interest and entitle the borrower to the discharge.

In the end, both the trial court and the Court of Appeal dismissed the borrower's claim. However, in light of the bank's willingness to discharge the mortgage and the general security agreement upon payment of the principal, interest and a reasonable amount in trust for costs, the Court of Appeal ordered the bank to provide a new statement of the outstanding loan principal and interest; if the borrower paid the stipulated amount, it would be entitled to the discharge that it sought. The borrower was also required to pay $8,000 into court as security for the bank's legal costs. See *All-Mar Development Ltd. v. HSBC Bank Canada*, 2010 (ONCA).

Beware of Mortgage Lenders Legislation

In the current economic climate, potential buyers of commercial properties have sometimes had to be more creative when trying to obtain financing for the transaction. A common approach is for the vendor to give a take-back mortgage of all or part of the balance, with the buyer giving a mortgage that is registered on title.

Straightforward as that may seem, there are some potential pitfalls: the Ontario *Mortgage Brokerages, Lenders, and Administrators Act*, which has been in force since July 1, 2008, strictly governs those individuals and organizations involved in the mortgages industry. (And breach of the Act's requirements can attract fines, the revocation of licenses, and other sanctions meted out by the Financial Services Commission of Ontario.)

In particular, the Act states that anyone who "carries on business" in Ontario as a mortgage lender, or who deals, trades or administers mortgages, is subject to licensing requirements established by regulation. In this context, "mortgage lender" specifically includes a person engaged in lending money in Ontario on the security of real property, which would extend to vendors giving take-back mortgages on a regular basis. On the other hand, "carries on business" is not defined in the Act, but there must generally be a pattern of conduct rather than a single instance.

This means that a vendor who lists or advertises property together with an offer to provide the

purchaser with a vendor take-back mortgage could run afoul of the licensing requirements if this pattern of conduct amounts to the business of mortgage lending.

Naturally, this will be more of a concern for vendors with a large portfolio of properties, rather than those with one or two listings and no established history of giving vendor take-back mortgages at all.

Still, all vendors should take care not to inadvertently hold themselves out as being in the business of mortgage lending, whether by way of advertisement, listing, or written or oral representations to prospective buyers. Also, the mere fact that a vendor has hired a lawyer to negotiate, draft and/or register a vendor take-back mortgage will not insulate that vendor from needing to be licensed under the Act.

Commercial Agreements – A Market-Prompted Review of Provisions

Against the background of the ever-shifting commercial real estate market, it is especially important to periodically review the specific provisions contained in agreements of purchase and sale for commercial properties, from the points of view of the mortgage lender, the seller, and the buyer.

For the mortgage lender:

In situations where the buyer is expected to assume an existing mortgage, in the current climate it is no longer a foregone conclusion that the mortgage lender will consent to the sale. Rather, the lender may want to make its consent subject to additional conditions, such as a guarantee from the buyers. The lender may also want to insist on a large assumption fee and the payment of costs. (On the other hand, in today's market these fees and costs – which were historically borne by the buyer – are often the subject of negotiation, and the vendor and/or the lender may want to agree to split the fees or absorb the costs).

Secondly, lenders are usually not willing to renegotiate the terms of an assumed mortgage with the buyer. In fact, mortgage lenders are increasingly seizing on the opportunity of the assignment to insist on the addition of enhanced security, such as the addition of environmental covenants/indemnities, or the requirement for non-disturbance and attornment agreements from later-ranking tenants.

For the buyer:

The buyer will want a condition that the terms and conditions of the about-to-be-assumed mortgage are satisfactory to it, and that the buyer has approved the form and content of any assumption agreement and other closing documents required by the lender. This may take longer than the usual due diligence period given to the buyer because satisfaction of this condition may be delayed if the lender does not provide the assumption agreement for approval expeditiously.

Also, the preparation of the mortgage assumption document can be expensive for the buyer, and can involve delay. This is because – in addition to requiring a guarantee or new general security agreement or an assignment of new leases – the lender may also want an opinion on title and updated off-title searches, and/or copies of the buyer's environmental and other due diligence reports. All of this takes time to gather, and the relevant dates for the transaction should be adjusted accordingly.

For the seller:

The agreement of purchase and sale should also contain a condition that the mortgage lender's consent – both to the sale of the property and the assumption of the mortgage by the buyer – has been obtained. (This protects the seller's right to terminate the agreement in the event the lender's consent is not forthcoming.) In the past, the timing for this condition has usually been tied to the buyer's due diligence period. In the current market, however, a longer period may be needed to accommodate mortgage lenders' more stringent requirements.

Finally, in today's market the seller may not be able to negotiate a release of its own liability to the mortgage lender, despite the assumption of the mortgage by the buyer. If this is the case, and given that the seller remains responsible for payment of the mortgage debt until it has been discharged, the seller should obtain an indemnity from the buyer. Naturally, the seller will want to confirm that the buyer can make good on the indemnity and/or provide adequate security. In order to secure the purchaser's indemnity, the seller may want to take a second mortgage on the property, or an alternate form of security.

LEGAL ALERTS

2010 Federal Budget Initiatives

The 2010 federal budget contains provisions which affect the mortgages market. Here are the highlights of the upcoming changes:

- *Mortgage Pre-Payment Penalties* – New regulations will require federally-regulated lenders to standardize the calculation and disclosure of mortgage pre-payment penalties.
- *Credit Unions* – Credit Unions will be allowed to incorporate and function at a national level instead of just at a provincial level, which will enhance competition amongst lenders.
- *Covered Bonds* – The government will help federally-regulated financial institutions diversify their funding sources by introducing legislation setting out a framework for covered bonds, which are debt instruments secured by high quality assets, such as residential mortgages.

New Legislation Changes Law for Commercial Properties

The Ontario government's recent enactment of the *Good Government Act, 2009* has implemented a number of housekeeping changes affecting numerous industries. As it affects real estate, the Act repeals the *Certification of Titles Act*, which had provided a mechanism for an owner of land, whether or not it was encumbered, to apply to the Director of Titles to have land title certified in the owner's name. (This procedure was designed as a means for resolving title disputes and formalizing possessory title interests such as easements.) Applications for title certification are now made under the *Land Titles Act*, and access to the Land Titles Assurance Fund has been maintained to compensate individuals who suffer loss as a result of Certificate of Title errors.

Kenneth G. Hood joins the firm

Ken is our newest lawyer, and brings a wealth of expertise to the firm. His practice is focused on corporate and commercial litigation, with emphasis on mortgage and debt enforcement, contractual disputes, real estate and condominium litigation, and shareholder/partnership disputes. Ken has extensive experience before all levels of court, and was called to the Ontario bar in 1982. He is a member of various national and provincial law associations, and serves on the Board of Directors of the Advocates Society.

The statements of law and comments contained in this Newsletter are of a general nature. Prior to applying the law or comments to any specific problem, please obtain appropriate legal advice.