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CHAPTER 15

INTRODUCTION TO MORTGAGE LAW

Learning Objectives

After studying this chapter, a student should be able to:

- ☒ Explain the concept of a “mortgage” and the differences between a “mortgagee” and “mortgagor”
- ☒ Explain the difference between a legal mortgage and an equitable mortgage
- ☒ Describe the implied and express terms of a mortgage
- ☒ Recognize and describe an interim blanket mortgage, a vendor take-back mortgage, a reverse annuity mortgage, and bridge financing, and explain why each might be used
- ☒ Understand the scope and effect of the federal *Interest Act* and *Criminal Code* and explain how they affect mortgages
- ☒ Explain the scope and effect of relevant provincial legislation and how they affect mortgages
- ☒ Explain how a lender assigns a mortgage, and the rights and obligations of the lender, the borrower, and the assignee
- ☒ Explain how a mortgage can be assumed and what risks are involved, including the continuing liability of the original borrower
- ☒ Apply the provisions of various provincial and federal legislation to the issue of priority
- ☒ Describe the relief available to a lender in a foreclosure proceeding
- ☒ Describe the steps involved in a foreclosure proceeding that ends in a sale by the owner, judicial sale, order approving sale, or order absolute of foreclosure, and the rights of the parties involved
- ☒ Describe an agreement for sale and how it differs from a vendor take-back mortgage

INTRODUCTION TO MORTGAGE LAW

Definition of a Mortgage

It is important to distinguish between the financial and legal aspects of a *mortgage*. In the chapters on mortgage finance, the emphasis is on the mortgage loan. Legally, however, a mortgage is not a loan. The mortgage grants an estate in land to the lender as security for a loan made by a lender (the mortgagee) to the borrower (the mortgagor).

Although almost all mortgage agreements contain a promise to repay a debt, a mortgage is not a debt itself. It is evidence of a debt and of the security for repayment of the debt. Historically, a mortgage was a transfer of legal or equitable title to land on the condition that the title would be reconveyed when the terms of the mortgage contract were performed, usually upon repayment of the debt. The modern effect of a mortgage varies from province to province. In some provinces, such as Alberta, the legislation is clear that a mortgage operates only as a charge on title to the property to secure repayment of debt and is not a transfer of the property. In British Columbia, the predominant view is that although title to the property remains registered in the mortgagor's name in the land registry system, a mortgage retains its common law character and operates as a transfer of the mortgagor's interest in the property to the mortgagee.

In almost all cases, the primary obligation in a modern mortgage agreement is the repayment of borrowed money. As a result, the relationship between parties to the mortgage is one of debtor and creditor. As you will see from Figure 15.1, the borrower is called the mortgagor and the lender is called the mortgagee. The mortgagor (borrower) grants the mortgage and receives the loan. The mortgagee (lender) receives the mortgage and grants the loan.

mortgage

an estate in land; a document evidencing a debt owed by the borrower (mortgagor) to the lender (mortgagee). Registration of the mortgage in the land title office transfers the mortgagor's interest in land to the mortgagee as security for the repayment of the debt and creates an enforceable security interest in the land

FIGURE 15.1: Parties to the Mortgage

LENDER	BORROWER
<ul style="list-style-type: none"> called a MORTGAGEE provides loan to borrower receives mortgage as security for the loan 	<ul style="list-style-type: none"> called a MORTGAGOR obtains loan from lender grants mortgage as security for loan

Historical Development

The history of the legal systems of common law and equity was discussed in Chapter 1: “Fundamentals of Law”. At common law, the legal effect of a mortgage was to convey both the title to land and the possession of the land to the lender. This conveyance was absolute, subject only to the lender's promise to reconvey the land to the borrower if the specified sum was repaid by the specified date. If the borrower failed to comply with the terms, the land stayed the lender's and the borrower had no further claim to the land. Since the law at that time did not allow for an agreement to serve as security for a debt, the land and possession of it had to be transferred to the lender to provide the security.

Common law and equity treated mortgages differently. The common law courts took the view that a mortgage, like any other contract, had to be performed exactly according to its terms. This meant that if a borrower was even one day late in making a payment, the borrower's land was forfeited to the lender and yet the borrower would remain liable for the debt.

The courts of equity concluded this result to be unfair and created an implied term in the mortgage contract giving the borrower an equitable right to redeem (repay) the mortgage after the contractual date for payment. Generally, the time allowed by the courts of equity was six months, but could be varied. This equitable right to redeem after the payment date became known as the doctrine of the equity of redemption.

The effect of the doctrine of the equity of redemption was a lender, who would have legal title to the property on which the mortgage had been placed, could apply to a court of equity for termination of the borrower's equitable right to redeem the property where the borrower was in default on the mortgage loan. This action was the basis for what today is known as a foreclosure proceeding. The current foreclosure process in British Columbia will be discussed later in this chapter. As a result of the merger of the courts of law and equity, mortgage law in Canada retains both the doctrine of the equity of redemption and the foreclosure action.

The doctrine of equity of redemption is a different concept from what property owners today describe as the “equity in their property”. Once a mortgage is registered on property, the owner/borrower’s financial interest in the property is reduced by the amount owing on the mortgage. In other words, if a property is worth \$500,000 with a mortgage securing \$100,000 that is owed to the lender, the borrower’s “equity” in the property is \$400,000. As the property value goes up or down, the equity increases or decreases. Similarly, as the borrower makes payments on the mortgage and the outstanding balance decreases, the borrower’s equity will increase. A borrower will find it increasingly difficult to arrange subsequent mortgages, because each successive mortgage of the equity of redemption reduces the gap between the market value of the property and the total amount secured against it. For this reason, second or subsequent mortgage loans will generally be for smaller amounts and bear higher rates of interest.

LEGAL AND EQUITABLE MORTGAGES

In British Columbia, under the Torrens system of land title registration, a mortgage must be registered as a charge against title to the property pursuant to the *Land Title Act* in order to be an enforceable security interest and to have legal effect as against third parties. Once registered, the mortgage takes priority over all subsequent charges and unregistered interests in the property, subject to priority given to certain parties under federal and provincial legislation (discussed later in this chapter). The lender receives the right to commence foreclosure proceedings in the event of default and to take title to the property by order absolute or sell the property through the judicial sale process. The borrower retains the right to redeem the mortgage until order absolute is granted or the property is sold by the lender.

However, certain agreements between a lender and borrower that are not (and perhaps cannot be) registered on title as a legal mortgage may be recognized as an equitable mortgage and are enforceable against the borrower, but not against third parties. Equitable mortgages are created by the following methods.

By Deposit of the Duplicate Certificate of Title

It was explained in Chapter 4: “The Subdivision of Land and Title Registration in British Columbia” that a fee simple owner of property which is free of any registered mortgages or agreements for sale can apply to the registrar of the land title office for the issuance of a duplicate certificate of title. This document can be used to create an equitable mortgage. This involves handing over to the lender the duplicate certificate of title as security for the loan. The reason this provides security is because the registrar will refuse to register certain subsequent dealings with the land in question such as a transfer, mortgage, or long term lease without the duplicate certificate of title being delivered to the registrar for cancellation. To be effective as a mortgage, there must be an actual delivery of the duplicate certificate as well as an intention of the parties to create a mortgage. If the documentation accompanying the duplicate certificate of title does not clearly express the intention to create an equitable mortgage, then a court may determine that the deposit is simply to keep the document safe or to ensure that the borrower doesn’t transfer or encumber title to the property (*Royal Bank of Canada v. Mesa Estates Ltd.* (1985), 70 BCLR 7 (CA)). Financial institutions rarely request a duplicate certificate of title as security and instead will require mortgage registration pursuant to the *Land Title Act*.

By an Agreement to Give a Mortgage

An agreement to grant a mortgage in the future is recognized as a present equitable mortgage. Also, a mortgage that is granted, but for procedural reasons is not registrable, is recognized as an equitable mortgage. In this case, the lender should file a caveat to protect its position until the document is in proper registrable form and registered on title. The mortgage must be one which is procedurally unregistrable (i.e., not in the required form), not one which is prohibited by statute. For example, an equitable mortgage by the deposit of the duplicate certificate of title cannot be registered because it is prohibited by statute. Therefore, it cannot be protected by the filing of a caveat because one cannot do indirectly what cannot be done directly.

By Disguising a Mortgage as a Transfer

Under its equitable jurisdiction, a court can look beyond the form of an agreement to determine substance. An example of this was provided in Chapter 6: “Commercial and Residential Tenancies” where it was explained that a court may determine that what the parties have described as a licence is, in substance, a lease.

On rare occasions, a loan agreement may be drawn up to appear as an absolute transfer of the estate in fee simple. This is done to circumvent the doctrine of the equity of redemption. If it is demonstrated that the main purpose of the transaction was to offer land as security for a loan, the court will find the arrangement to be a mortgage, and will recognize the equity of redemption.

IMPLIED TERMS OF A MORTGAGE

A contract may contain express terms and implied terms. Express terms are those that are stated outright in the contract. For example, in a mortgage agreement, the amount of money advanced, the frequency and amount of each installment payment, and the mortgage maturity date are all express terms. Implied terms are those that are not specifically stated in the contract but may be implied by statute or case law in order to create a notion of reasonableness and fairness in business dealings, especially when one party to a contract is less sophisticated than the other, which is frequently the case with mortgage contracts.

The Prohibition Against Clogging

There is one principle which is fundamental to mortgage law: a borrower cannot be prevented by the terms of the mortgage from eventually redeeming their property free from the conditions contained in the mortgage. This is what is meant by the expression: “there shall be no clog on the equity of redemption”. The effect of this principle is to render invalid any term in a mortgage which “clogs” the title; in other words, prevents the borrower from being able to redeem their legal title free and clear of all charges, upon repayment of the loan. If a borrower repays the loan, they must be able to have title restored to the same state as it was at the time of the making of the mortgage. Any term in a mortgage seeking to provide otherwise will be of no effect (the lender cannot enforce it).

The most common example of a clog on the equity of redemption is an option to purchase the property provided to the lender at the time the loan is negotiated. If the option were to be exercised by the lender, the borrower would be prevented from redeeming the property. Such an option is therefore void. However, an option to purchase granted after the loan is negotiated and which is independent of the loan agreement is enforceable as a separate transaction unrelated to the mortgage.

A term which makes the redemption date so distant as to result, in practical terms, in the mortgage not being redeemable (for example, 100 years) will also be void. However, a term which merely prohibits or restricts prepayment of the mortgage prior to the maturity date or prevents the assumption of the mortgage (for example, by a buyer of the mortgaged property) does not constitute a clog on the equity of redemption and can be enforced.

Stipulations for a Collateral Advantage

Although a mortgage term cannot clog the borrower’s equity of redemption, it is common for mortgages to contain terms giving the lender advantages in addition to the principal and interest payments. For example, the borrower who owns a gas station may promise that during the term of the mortgage they will purchase only the lender’s automobile products. Originally, all collateral advantages which extended past the redemption date of the mortgage were void, because a mortgage had to be redeemable free from all conditions and such terms were regarded as clogs on the borrower’s equity of redemption. For the same reason, a collateral advantage which lasted only for the term of the mortgage would not be a clog and would be enforceable. This was because the collateral advantage would cease on redemption.

As the law now stands in British Columbia, the court will consider whether a collateral advantage was intended to be a term of the mortgage or whether it was the subject of an independent bargain which was connected with a mortgage as part of a larger transaction. If it is a term of the mortgage, then it will be void if it continues after redemption. If it is the subject of an independent bargain, then it may be valid after redemption. Therefore, each mortgage where this might be an issue must be assessed on its own facts.

The Principle of Good Faith and the Duty of Honest Performance

In *Bhasin v. Hrynew*, 2014 SCC 71, the Supreme Court of Canada unanimously recognized a general principle of good faith performance in contract law and that under this organizing principle, parties to a contract are under a duty to act honestly in the performance of their contractual obligations.

It is unclear at this time how the decision could affect mortgage transactions as lower courts continue to apply the decision in various contexts. In *1026238 B.C. Ltd. v. Pastula*, 2016 BCSC 1812, the respondent borrowers challenged foreclosure proceedings on the basis that the lender had made oral concessions that it would allow the borrowers time to cure the mortgage default. The borrowers argued that the lender breached the duty of good faith and fair dealing by commencing foreclosure without giving them ample time to cure the default. The court noted that the duty of good faith and fair dealing only addresses a party's legitimate contractual interests and there was no evidence that oral concessions or negotiations, in the absence of consideration, constituted a new contract. As a result, the court declined to impose the duty on the lender. The decision was upheld on appeal to the British Columbia Court of Appeal.

EXPRESS TERMS OF A MORTGAGE

An analysis of some of the basic clauses contained in most mortgages is set out below. It should be emphasized, however, that the wording varies and the types of clauses may be changed to conform to the particular type of security mortgaged. The following discussion sets out some of the most common provisions used in British Columbia and their legal effect. When reading the basic clauses, remember that the lender is called “the mortgagee” and the borrower is called “the mortgagor”.

Land Title Act

The *Land Title Act* was amended in early 1990, and one of the changes made was the adoption of a two-page, two-part mortgage document (see Appendix 15.1) which is now the only mortgage document that the land title office will accept for registration. The prescribed form is referred to as the “Form B”. Part 1 of the Form B contains the parties, the legal description of the property, the signatures of the parties and their witnesses, and other specified information and terms. Part 2 contains all the other terms of the mortgage, which may be the standard form prescribed by regulations under the *Land Title Act*, a set of the lender's own standard terms which the lender has filed with the land title office, or express terms included in the Form B in Part 2 or an appendix to Part 2.

A lender may modify any term contained in a set of standard or prescribed mortgage terms by filling in a specified section in Part 1 of the Form B.

Where a set of standard mortgage terms is used in a mortgage, the borrower must receive, at or before the time the mortgage is signed by the borrower, an exact copy of the standard terms together with any modified terms included in the document. The lender must obtain an acknowledgement from the borrower that they have received these standard terms and modifications. Unless such delivery is made and acknowledgement obtained, the mortgage will take effect as though the parties had used the set of standard mortgage terms prescribed in the *Land Title Act* regardless of the fact that these may differ substantially from the terms actually intended to be used by the parties.

Common Clauses in Part 2 of the Form B Mortgage

The following clauses are typically found in the prescribed standard mortgage terms, the lender's own standard mortgage terms, or the express terms that comprise Part 2 of the Form B mortgage.

Repayment Clause

The principal sum of _____ dollars, together with interest at the rate aforesaid shall be payable in equal consecutive monthly instalments in the amount of _____ dollars each, commencing on the ____ day of _____, 20__, and continuing on the ____ day of _____, 20__, and the balance of principal outstanding on the last mentioned date, together with accrued interest, shall then become due and payable. Each of the monthly payments when received shall be applied firstly in payment of interest calculated at the rate aforesaid, and secondly in reduction of the principal sum. Interest shall accrue before maturity and before and after default.

In the repayment clause above, note that the full amount outstanding is due and payable on a fixed date after the loan is made. It is common in residential mortgages to calculate the payment which will repay the principal amount over twenty, twenty-five or thirty years. This is called the amortization period. However,

the term of the loan is typically five years or less. This means that after the term ends, otherwise known as the mortgage maturing, the borrower must pay out the balance still owing, re-negotiate with the lender at the then current rate of interest, or change lenders. Many institutions offer six-month, one, two, or three-year terms as well.

Acceleration on Default

The principal and interest secured hereby shall become due and payable forthwith, at the option of the mortgagee in each of the following events:

- (a) *default in payment of principal or interest due under this mortgage;*
- (b) *default in payment of monies payable by the mortgagor under charges in priority to this mortgage, or for taxes, or for insurance premiums;*
- (c) *the mortgagor or those claiming under the Mortgagor commit any act of waste or in any other way cause or permit the value of the land to diminish.*

An acceleration clause allows the lender, upon the borrower's default, to demand payment in full of the outstanding balance on the mortgage even if the mortgage has not yet matured. The acceleration clause operates at the option of the lender so that the borrower cannot compel the lender to act under it simply by failing to make payments or defaulting in some other way. The lender would not want a clause which forced it to act. For example, if a mortgage was at an interest rate of 15%, but over time the market rate decreased to 9%, the lender would not want the mortgage to accelerate automatically on default. If it did, the lender would lose a good investment because it would not be possible to receive a 15% rate of return on its money in the current market.

Typically, a lender will commence foreclosure proceedings after it accelerates the balance due under the mortgage and the demand for payment expires. A court will not always permit acceleration where the borrower can explain the default and can satisfy the court that they are willing and able to fulfil their obligations. Section 25 of the *Law and Equity Act* gives the court discretion to grant relief against acceleration clauses. However, under section 28, the court can only grant such relief once where the same party and the same covenant is involved.

Omnibus Clause

In default of any payment of monies to be made by the mortgagor under the provision of this mortgage, the mortgagee may pay the same and the amount so paid shall forthwith be added to the principal hereby secured, carrying interest at the said rate and shall be payable to the mortgagee forthwith.

This clause gives the lender an alternative to accelerating the loan if the borrower defaults. It could be used where the borrower promises to pay property taxes or strata charges as part of the mortgage agreement and those property taxes or strata charges are unpaid but the mortgage is otherwise in good standing.

Insurance

The mortgagor will insure the buildings on the said lands to the amount of their replacement value or, if the mortgagee so elects, such lesser amounts as the mortgagee may determine, in Canadian currency; the mortgagee shall have a lien in the amount secured hereby against all insurance on the said buildings; in any event, the mortgagee shall not be liable for any failure to insure the buildings, the non-payment of premiums on any policy, or any loss arising out of any defect in any policy or failure of any insurer to indemnify for any loss; forthwith in the event of any loss or damage by fire, and at the expense of the mortgagor, the mortgagor will furnish all proofs and do all acts necessary to enable the mortgagee to obtain payment of the insurance monies under such insurance.

As the buildings on the mortgaged land form a part of the lender's security and usually increase the value of the property, it is crucial that a lender require proof that the property is adequately insured.



As a Licensee...

You should advise your buyer clients to consult with their mortgage brokers to ensure they have a full understanding of any funding requirements that could potentially impact their transactions, such as adequate insurance. As the risks from natural disasters increase due to climate change, this is particularly important because more buyers may not be able to obtain adequate insurance (or meet other funding requirements) as the number of properties near alert or evacuation areas increases.

Repairs

The mortgagor will keep the land and the buildings thereof in good condition and repair, and will not abandon or commit waste upon the same.

This clause sometimes provides that the borrower cannot make any alterations or improvements to the property without the lender's consent. The purpose of this clause is to make sure that the value of the lender's security is maintained.

Fixtures

As between the parties hereto, all heating, refrigeration, gas, electric, plumbing, cooling and air conditioning equipment and apparatus, and all wall-to-wall carpets, awnings and blinds upon or hereafter placed upon or installed in the land shall be deemed to be fixtures and comprised in the freehold whether or not attached to the land.

In an earlier chapter the problem of whether or not items placed on the property were to be considered chattels or fixtures that had become part of the property was discussed. The purpose of this clause is to provide greater certainty as to which items are part of the property. As fixtures generally increase the value of the property, the more items that are considered fixtures, the greater the lender's security.

Lender's Remedies

The mortgagee shall not be required to realize upon or enforce any security collateral to this mortgage before enforcing the security granted hereby, any rule of law or in equity notwithstanding.

This clause gives the lender complete discretion in deciding the most suitable remedy if the borrower defaults, including remedies under other security for the same debt.

Advances

The mortgagee shall not be bound for any reason whatsoever to advance any part of the money intended to be secured hereby.

This clause gives the lender complete discretion in deciding whether to advance some or all of the money secured by the mortgage. Some mortgages provide for monies borrowed and secured by the mortgage to be advanced in stages. For example, a mortgage may secure the principal sum of \$500,000 to be used to construct a house on a lot, but the lender, pursuant to the loan agreement and mortgage terms, will only advance the money in stages as the construction progresses. Advancing money in stages protects the lender and minimizes potential losses if the construction fails to complete or if a builders lien is filed against the property, in which case the lender will require that the lien be removed before advancing further funds. The benefit to the borrower is that interest is only payable on the amount of funds advanced.

A home equity line of credit is another type of mortgage product where funds are not advanced in full at the time of mortgage registration. This allows a borrower the flexibility to take out money as needed. However, if a lender receives notice that a judgment or new mortgage is being registered, the lender will want to ensure that no further funds are advanced on the line of credit to avoid losing priority of the further advances to the judgment holder or new mortgagee. This priority issue is discussed later in the chapter.

Costs

The mortgagor shall pay to the mortgagee upon request all costs, charges and expenses of and incidental to:

- (i) the preparation, execution and registration of this mortgage; and*
- (ii) all proceedings taken by the mortgagee to enforce this mortgage or the mortgagee's remedies under it.*

All such costs, expenses and charges shall be determined and paid on a solicitor and client basis. In the event of non-payment of the said costs, expenses and charges within thirty (30) days of such request, the amount thereof shall be deemed to constitute principal under this mortgage and shall bear interest at the said rate and be paid forthwith.

It is customary for the borrower to pay all legal and registration costs in connection with the mortgage transaction. In British Columbia, costs clauses have been extensively limited by case law and the *Law and Equity Act* such that the lender is only entitled to recover a portion of its actual costs incurred in a foreclosure proceeding.

Charges in Priority

The mortgagor shall pay as and when due all monies payable under charges in priority to this mortgage and observe and perform all the terms, provisos, covenants and conditions in the encumbrances prior hereto; and the mortgagor will duly pay all taxes, levies and assessments whatsoever affecting the land and all premiums for insurance effected pursuant to this mortgage.

This clause protects the lender's security position, because it requires the borrower to keep charges having priority over the mortgage in good standing, and to pay taxes, strata charges, etc. A similar term in many standard and express mortgage terms allows the lender to pay charges having priority, without consent of the borrower, and to add the payment to the mortgage balance. See discussion on the "Omnibus Clause" in this chapter.

Further Charges

The mortgagor agrees not to further mortgage, charge, hypothecate or encumber the property without the lender's prior written consent.

To provide further protection to the lender against a potential claim by subsequent mortgagees or charge holders, the lender may require that the borrower not place any further mortgage or charge on title without the lender's consent.

Strata Property Clause

- (a) The mortgagor will duly observe all the provisions of the Strata Property Act and the bylaws of the strata corporation of which they are a member by reason of being owner of the land, or part thereof, and will duly pay all levies made by the said corporation in respect thereof and perform all their duties as an owner and member; and*
- (b) the mortgagor hereby assigns to and confers on the mortgagee the right to exercise the mortgagor's power to vote on all matters as an owner and member of the said corporation.*

As explained in Chapter 7: "Strata Properties (Condominium) and Cooperatives in British Columbia", the *Strata Property Act* provides that a lender can obtain the right to vote at meetings of the strata corporation on matters relating to insurance, maintenance, finance or other matters affecting the security of the mortgage. The lender must give notice to the strata corporation and the borrower of its intention to vote at a meeting before it can do so.

In addition, the lender will want the right, but not the obligation, to pay any special levies, strata maintenance fees, or owner's share of a judgment to the strata corporation not paid by the borrower, which have statutory priority over the lender's mortgage.

Guarantor

The guarantor, in consideration of payment by the mortgagee to the mortgagor of any part of the monies to be secured hereby, covenants and agrees with the mortgagee as follows:

- (a) *to duly pay to the mortgagee the monies hereby secured;*
- (b) *to be bound by and duly perform and observe each and every covenant and proviso herein by the mortgagor agreed to be performed and observed; and*
- (c) *that the guarantor's liability hereunder shall not be affected by any partial release of this mortgage or of any or all collateral or other securities held by the mortgagee or by the extension of time for payment, or the taking of any note or other obligation for payment of the monies hereby secured, or any indulgence to the mortgagor or any act whatsoever done either with or without notice to the guarantor.*

This clause is used to create a separate personal covenant of a third party in addition to the borrower's personal covenant to pay. This gives the lender additional security. A lender will typically require a *guarantor* on a mortgage where the borrower's income or assets are insufficient on their own to meet the lender's or mortgage insurer's borrowing guidelines. Upon default, the lender is able to pursue the guarantor for judgment on the mortgage debt and enforce the judgment if the lender suffers a deficiency when the property sells.

guarantor
one who becomes contingently or secondarily liable for another's debt or performance

The Difference between Covenantors and Guarantors

When issuing a loan to a borrower, a lender may require a third party, in addition to the primary borrower, to take on the borrower's obligations under the mortgage. This means that if the borrower is unable to repay the mortgage, the third party may be responsible for repaying the lender in the borrower's place. This third party may either be a covenantor or a guarantor.

These two terms are sometimes used interchangeably, occasionally in the same document. For example, the body of the agreement may impose covenantor obligations, but the signature line may identify the third party as a guarantor. This is a mistake, as a covenantor and a guarantor are not the same thing, and the difference affects how a lender may recover from the third party in the event that the borrower is unable to repay their loan.

A covenantor is a primary debtor and is responsible for the loan as though they themselves were the borrower. This means that a covenantor is responsible for the obligations both alone and together with the borrower. Furthermore, the lender may collect from the covenantor before the lender exhausts all available remedies against the borrower.

A guarantor, however, is a secondary debtor and will only be responsible for repaying the borrower's loan after the lender has exhausted every available remedy against the primary debtor. Therefore, it is easier for lenders to enforce loans against a covenantor than a guarantor.

To interpret these agreements, courts will look to the body of the contract's text to interpret what the parties truly intended. If the agreement uses the term "guarantor," but, based on the wording, the parties contracted for the responsibilities of a covenantor, a court will likely impose the obligations of a covenantor. Agreements must therefore be carefully structured and reviewed, to ensure the result is as the parties mutually intended.

Due on Sale Clause

In the event that the Mortgagor sells, agrees to sell or otherwise disposes of the said lands, the full amount then owing of the principal and interest secured hereby shall become due and payable forthwith, at the option of the Mortgagee.

This clause effectively prevents the mortgage from being assumed by anyone unacceptable to the lender. Assumption is discussed at length later in this chapter. If a mortgage does not contain this, or a similar clause, the mortgage will be assumable. A variation on this clause might provide that the mortgage is assumable only where the lender gives written approval prior to the sale. If a lender enforces a due on sale clause, all amounts owing under the mortgage (including a prepayment penalty) would be due and owing.

Portability

If the mortgagor repays the mortgage money in connection with a genuine sale of the property to a person with whom the mortgagor deals at arm's length and completes the purchase of a new residence within sixty days of repaying the mortgage money, the mortgagee will, on application by the mortgagor, provide financing for the purchase of the new residence on the security of a mortgage (the "New Mortgage") on such residence, on the following basis...

This clause allows a borrower to take their current mortgage to a new property, thus allowing the borrower to maintain their current favourable interest rate. If additional money is required by the borrower, the lender usually allows for a blended rate combining the “old” loan amount at its rate of interest with the “new” loan amount at current interest rates. If more money is required for the new property, the borrower will also have to requalify for the mortgage with potentially more stringent requirements.

SPECIAL TYPES OF MORTGAGES

Interim Blanket Mortgage

An interim blanket mortgage is commonly used in condominium developments or subdivisions. In order to initially raise money for the project, a mortgage is placed on the whole development. However, the developer/borrower will want to release this mortgage from the individual strata lots or subdivision lots as they are purchased. Therefore, the blanket mortgage will contain a clause which permits the mortgage to be released from each individual lot as it is purchased, but keeps the security over the rest of the project. The purchase price or part of it is, of course, paid to the lender. The following clause is typical:

When the land...is converted into strata lots...so long as the Mortgagor is not in default...the Mortgagor shall...be entitled to the release or discharge of this mortgage...from any of such strata lots sold in bona fide arm's length sales, upon payment...of a sum equal to the greater of:

- (a) *The selling price of each strata lot after deduction of...commissions paid to licensed real estate agents...; or*
- (b) *“X” dollars per square foot for each such strata lot for which a discharge is requested PROVIDED THAT no more than “Y” percent of the strata lots...shall be released or discharged...until such time as all monies owing hereunder have been paid in full.*

For example, where a development involves 10 strata lots and a mortgage of \$100,000 is placed over the development, the developer can pay \$10,000 to the lender and request a partial discharge of the mortgage on a particular strata lot. The buyer of this strata lot obtains title free of the mortgage, and the lender still has a mortgage over the remaining 9 lots.

Vendor “Take-Back” Mortgage

A vendor “take-back” mortgage involves the seller “taking back” a mortgage for part of the sale price of the property.

Example

Laura is nearing retirement and wishes to sell her home to buy a small condominium. Her home is worth \$750,000 and she has clear title. She only requires \$400,000 to purchase the condominium she wants. Instead of accepting \$750,000 cash for her house, Laura agrees to accept \$400,000 and asks the purchaser to give her a mortgage of \$350,000. Laura therefore gets the cash she needs, and “lends” part of the price to the purchaser, “taking back” a mortgage in exchange. The fee simple title is registered in the name of the purchaser, with a mortgage in favour of Laura registered against it.

A vendor “take-back” mortgage and a conventional mortgage are very similar, except that the mortgage funds are not advanced by the vendor under a “take-back” mortgage. Rather, the vendor and purchaser agree to defer payment of a specified portion of the purchase price, according to the terms of the “take back” mortgage.

Vendor financing may be used where the purchaser does not qualify for financing through a conventional lender such as a bank or trust company or because the vendor is willing to give a lower interest rate on the mortgage than will a conventional lender. Unlike conventional mortgages, which are limited by statute to 80% of the property value (or a maximum of 95% if the mortgage is insured), there is no such restriction with private vendor financing. Also, the purchaser (borrower) may not have to pay certain fees for arranging the mortgage (such as appraisal, survey or administrative expenses) if the mortgage is given by the vendor of the property instead of by a financial institution.

vendor take-back mortgage

a mortgage taken back by the vendor from the purchaser to facilitate a sale, whereby the vendor becomes the mortgagee and the purchaser becomes the mortgagor

On the other hand, a seller may be willing to “take back” a mortgage on the property rather than receive cash for the full price if they will receive a higher rate of interest on the mortgage than if the money were invested in a savings account. The property may also sell faster if low rate financing is available, since a larger group of potential buyers will be able to afford the lower mortgage payments. However, buyers will usually pay more for a property with lower rate financing. In the next chapter, the method of calculating the market (or cash) value of an offer using a vendor “take-back” mortgage will be shown.



As a Licensee...

There are a number of important issues which may arise with vendor financing of which a licensee must be aware. When the licensee is acting for the vendor, the licensee must protect the vendor's best interests. Specifically, the licensee must ensure that the vendor receives a fair price for their property, and that the vendor receives adequate security for the “loan”. The true market value of an offer which involves the vendor “taking back” a mortgage at an interest rate lower than the current market rate must be calculated and disclosed to the vendor. In this situation, a licensee should recommend the vendor obtain legal advice.

Reverse Annuity Mortgage (RAM)

In a *reverse annuity mortgage*, the lender makes a series of payments or advances to the borrower over the term of this mortgage. At the end of the loan term or upon the death of the borrower, the loan balance, consisting of the accumulated principal advances and the interest due, is repaid by refinancing, by sale of the property, or from the proceeds of the borrower's estate. This innovative mortgage has been introduced in Canada as a means of supplementing aged homeowners' income, typically upon retirement. The arrangement allows the borrower to keep their home for a period of time while subsidizing a low retirement income.

reverse annuity mortgage

an innovative loan arrangement in which the lender makes periodic payments to the borrower during the loan term. At the end of the term, the borrower will have to repay the balance owing by refinancing or selling the property

Bridge Financing

Bridge financing, as the name suggests, is a type of interim financing whereby a borrower will receive a loan and grant a mortgage to a lender for a short period of time while long-term financing is being pursued. Bridge financing can be used where a borrower has purchased property but has not sold their existing property and financing to purchase the new property is required. Another situation where bridge financing is used is when a borrower needs immediate financing while a financial institution is considering the borrower's credit worthiness and arranging security for long-term financing. Lenders typically charge a higher rate of interest for bridge financing compared to conventional long-term financing.

FEDERAL LEGISLATION OVER MORTGAGES

Interest Act

The federal *Interest Act* imposes no limit on the rate of interest that can be charged in a mortgage transaction. However, a rate of interest can be attacked under provincial legislation if it is oppressive or unconscionable, or under the federal *Criminal Code* if it constitutes a criminal rate of interest. Both of these restrictions are discussed below. Under section 3 of the *Interest Act*, if a document requires interest to be paid but the rate is not set out, then the rate allowed by law is 5% per annum.

A mortgage can require payments of principal with interest to be calculated and paid separately, “blended” payments of principal and interest, or interest-only payments. Blended payments are those payments which do not separate the interest portion from the principal portion. Where a mortgage requires blended payments, sections 6 and 7 of the *Interest Act* apply. The purpose of these provisions is to provide the borrower with an interest rate they can understand and compare with or against other financing options. Section 6 requires that the mortgage document contain a statement of the interest rate calculated either

“yearly or half-yearly not in advance”. This requirement is more commonly expressed in practice as “annually or semi-annually”. If the mortgage document does not contain the required statement, no interest can be charged. Further, section 7 provides that where the rate in the required statement is lower than the rate in the repayment clause, only the lower rate can be collected.

The required statement may be worded as follows:

For the purposes of the Interest Act it is declared that the principal sum hereby secured is ____ \$ and the rate of interest charged thereon is ____ percent per annum calculated half-yearly not in advance.

However, these sections have been interpreted somewhat liberally. A lender complies with the *Interest Act* as long as the mortgage contains all of the information required by the *Interest Act*, even though the above statement is not included. In addition, recent cases indicate that payments will not be considered “blended” unless the portions of principal and interest in the payments specified are so mixed that they cannot be readily discerned. Note that if a mortgage merely requires interest at a set rate per annum, it will be assumed that it is to be calculated yearly, not in advance.

Sometimes the lender requests a “bonus” when negotiating a mortgage. For example, the lender may agree to a mortgage which has a face-value of \$100,000, but only \$90,000 is advanced to the borrower. The borrower must still repay \$100,000. The \$10,000 difference is called a bonus. Is this considered interest? The case law indicates that the amount of the bonus becomes part of the principal sum and is not “interest” for the purposes of section 6 of the *Interest Act*. However, a bonus can be considered interest under the *Criminal Code* for purposes of determining whether a lender is charging a criminal rate of interest.

Section 8 deals with the payment of interest on arrears. In particular, section 8 prohibits fines, penalties, or interest charged on arrears if the effect of doing so imposes a higher charge on arrears than that imposed on the principal owing that is not in arrears. In simple terms, this means that a lender cannot charge a higher rate of interest on monies owing after default. For example, many mortgages contain indemnity clauses which require an amount equal to three months’ interest to be paid where the lender has had to recover the loan after default. According to section 8, these clauses are unenforceable. The Supreme Court of Canada has held that the purpose of this section is to protect a borrower’s right to redeem by preventing charges that increase the cost of redemption and threaten equity. Two cases illustrate what type of charges a court does and does not consider as offending section 8:

1. In *Krayzel Corp. v. Equitable Co.*, 2016 SCC 18, the Supreme Court of Canada held that offering a discount on an interest rate that is removed upon default breached section 8 and was therefore void. The Court found that framing a lower interest rate before default as an incentive to prevent default could not save the loan from the *Interest Act* prohibition because in essence, it was charging a higher interest rate when the loan was in default than when it was not. On the other hand, an interest rate increase due solely to the passage of time, and not due to a default, does not violate section 8.
2. In *Bankers Mortgage Corporation v. Plaza 500 Hotels Ltd.*, 2017 BCCA 66, the British Columbia Court of Appeal held that a mortgage broker’s exit fee, payable to the broker if the mortgage is not paid on time but otherwise not connected in any manner to or secured by the mortgage, does not violate section 8.

Section 8 does not prohibit charging interest after maturity or default as long as the interest charged does not offend section 8 as discussed above. Section 8 also does not prohibit charging compound interest (i.e., “interest on interest”) provided that the mortgage expressly stipulates that compound interest is payable.

Section 10 is concerned with the right of an individual borrower to prepay their mortgage. A *prepayment* occurs where a borrower seeks to pay a substantial amount or the entire amount owing on the mortgage prior to the expiration of the mortgage term. Generally, any right of prepayment is a contractual matter governed by the specific agreement between the borrower and the lender. In many mortgage contracts, if the borrower seeks to pay the entire balance owing prior to the expiration of the mortgage term, the lender is entitled to charge a substantial *prepayment penalty* which often amounts to the interest that would have been payable to the end

prepayment

the act of fully or partially paying off the outstanding balance of a loan at any point during the term of the loan at a time earlier than set out in the contract

prepayment penalty

a fee that a lender may charge a borrower under the mortgage agreement in exchange for allowing the borrower to prepay their mortgage prior to the expiration of the mortgage term

of the mortgage term. However, where the criteria necessary for section 10 to apply are met, it is possible for a borrower to tender prepayment. Section 10 applies in the following circumstances:

- the borrower is an individual;
- the mortgage provides that it is not payable until a time more than five years from the date of the mortgage; and
- the expiration of the five years from the date of the mortgage has occurred.

Where these requirements are fulfilled, it is possible for the borrower to tender payment of all principal and interest outstanding, plus an additional three months' interest (as penalty for early payment). After this tender, no further interest may be charged by the lender. Therefore, the lender is unlikely to refuse such a tender from a borrower since no further interest could be charged.

Where a mortgage is renewed and the date of the mortgage is changed from the original date to the date of the renewal, then the renewal will have to exceed five years for section 10 to apply and the five-year waiting period for prepayment will also run from the date of the renewal. If, on the other hand, the term of the mortgage is extended and the date remains the original date, then for the purposes of section 10 the borrower will have the right to prepay at any time after five years from the original date.

Example

In 2005, Alexandra grants a mortgage due to mature in 2010 with no right of prepayment. In 2010, Alexandra signs a renewal agreement which extends the agreement for a further five years until 2015, and provides that the date of the mortgage be deemed to be changed from 2005 to 2010. In 2011, Alexandra receives an inheritance and wants to pay out the mortgage. However, even though the mortgage has been in existence for six years, section 10 does not operate to allow Alexandra to prepay. This is because the date was changed from 2005 to 2010 when the renewal was made and so the waiting period under section 10 begins to run in 2010. Alexandra is locked in for the whole of the renewal term because it is five years, the same as the waiting period under section 10.

Example

Quin grants a mortgage in 2005 for a five-year term with no right of prepayment. In 2010, Quin negotiates an extension to the mortgage for a further five years, maturing in 2015. The renewal agreement does not redate the mortgage. In 2011, Quin wins the lottery and wants to pay out the mortgage. Will section 10 apply? Yes, Quin can prepay. Six years have elapsed since the date of the mortgage (which remained the same when the mortgage was extended), and therefore Quin is entitled to tender payment in full along with the three months' interest. After making that tender, the lender is prohibited from charging any more interest.

There is no requirement under section 10 that the property mortgaged be residential; the important requirement is that the borrower must be an individual. Limited corporations (and joint-stock companies) have always been prevented from relying on section 10 of the *Interest Act*. Since January 1, 2012, partnerships, unlimited liability corporations and trusts settled for business or commercial purposes are also expressly prohibited from benefitting from this right of prepayment. However, these entities may still use section 10 to prepay a mortgage that was granted before 2012 if the other requirements of the *Interest Act* are met.

prepayment privileges

mortgage terms that allow the borrower to make partial prepayments on the mortgage prior to the expiry of the mortgage term, without penalty (e.g., "borrower may prepay up to 10% of the outstanding balance per calendar year, without penalty")

The lender's right to a prepayment penalty is lost once the mortgage balance is accelerated and demanded in full, for example, when the lender commences foreclosure proceedings.

Prepayment terms (including prepayment penalties and *prepayment privileges*) are important considerations for borrowers who are making decisions about mortgages. For example, a borrower should account for the prepayment penalty amount that they may need to pay when discharging their current mortgage as part of the sale of their property.



As a Licensee...

Mortgage agreements are often put into three general categories, based upon their prepayment terms:

- The first category of mortgage agreements allow the borrower to prepay as much of the mortgage principal as they wish at any time during the mortgage term, without penalty. These types of mortgage agreements are commonly referred to as “open mortgages”.
- The second category of mortgage agreements do not allow the borrower to prepay the mortgage at all. Rather, the borrower must only make mortgage payments based on the repayment schedule set out in the mortgage agreement. These mortgage agreements are commonly referred to as “closed mortgages”. Given the inflexibility of closed mortgages, they are not particularly common in today’s residential mortgage industry.
- The third category of mortgage agreements may contain terms that allow the borrower to prepay their mortgage balance before the due date, but only if the borrower also pays a prepayment penalty. Mortgage agreements in this third category may also contain prepayment privileges. Mortgage agreements in this third category are commonly referred to as “partially open mortgages”.

Lenders may use these names (“open,” “closed,” or “partially open”) when marketing their mortgage products. They may also use other names. Remember, the name of a particular mortgage is not necessarily determinative of that mortgage’s prepayment terms.

As a licensee, you should recommend your client to seek professional advice, such as from a mortgage broker, about the prepayment terms in their existing mortgage. Some borrowers may be surprised about how high the prepayment penalty may be in the event that they discharge their existing mortgage as part of the sale of a property.

The Criminal Code

Interest Rate

Under the *Criminal Code*, it is an offence for a person or corporation to enter into an agreement to receive interest at a criminal rate, which is defined as an effective annual rate of over 60%. This provision applies to all types of loans of any amount. The broad definition of interest in the *Criminal Code* includes the aggregate of fees, fines, penalties, bonuses, and commissions. In several cases, the court has interpreted profit-sharing and royalty payments to the lender in connection with the mortgage transaction as falling under the definition of interest in the *Criminal Code*. Therefore, it is easy to achieve the criminal rate of interest in certain mortgage arrangements.

Cabott v. 564546 BC Ltd., 2000 BCSC 579, demonstrates how the courts classify various fees as interest. The petitioner granted a mortgage for a loan in the amount of \$20,000 from the defendant company. The petitioner was required to pay \$1,200 in prepaid interest, and a premium of \$3,800 was payable on the due date in three months. The court found that these fees constituted interest, and the effective annual rate was calculated to be 157%. Since this amount is greater than the allowed rate of 60%, the court found that the defendant company was charging a criminal rate of interest.

Mortgage Fraud

The *Criminal Code* contains various prohibitions against theft or fraud related to mortgage transactions. For example:

- Section 331 makes it an offence for a person who acts under a power of attorney for the mortgage of property to fraudulently use the proceeds of a mortgage loan for an unauthorized purpose;
- Section 385 makes it an indictable offence for the agent of a seller to fraudulently conceal certain title information, including mortgage information, to induce a purchaser or lender to accept the title offered; and
- Section 387 makes it an indictable offence for a person who knows about an unregistered mortgage to fraudulently sell the property. The section does not define the word “fraudulently” nor specify in what circumstances the sale of a property with an unregistered mortgage would violate this provision.

R. v. Frebold, 2001 BCCA 205, illustrates the criminal liability of a licensee who participates in mortgage fraud. The client was an overseas investor who purchased a commercial building in British Columbia. The client formed

a company to hold and operate the building and hired the licensee to manage the property. The client gave the licensee a power of attorney to carry out activities for the client's company in connection with the building.

On behalf of the client's company, the licensee took out a mortgage of \$1.725 million dollars on the property. Without the client's knowledge or consent, the licensee used \$672,000 of the mortgage proceeds to lend money to the licensee's own company. When the licensee sent a copy of the mortgage by fax to his client in Germany, the licensee altered the document to show the amount as \$1.053 million dollars, being \$672,000 less than the actual amount of the mortgage. A jury convicted the licensee of fraud and forgery contrary to the *Criminal Code*. The court sentenced the licensee to 30 months imprisonment.

PROVINCIAL LEGISLATION OVER MORTGAGES

Business Practices and Consumer Protection Act

Eight of the provinces (Manitoba and Saskatchewan being the exceptions) have statutory provisions dealing with interest rates, including interest rates in mortgage transactions. These provisions allow a court to intervene where, having regard to the risk and to all the circumstances, the cost of the loan is excessive and the transaction is harsh and unconscionable. In the other two provinces, the provisions allow the court to intervene where the cost of the loan is excessive or if the transaction is harsh and unconscionable.

In British Columbia, section 8 of the *Business Practices and Consumer Protection Act* (the "Act") provides a number of factors that the court must examine in order to determine whether a transaction is unconscionable. All of the surrounding circumstances must be considered, including, but not limited to:

- whether there was undue pressure on the consumer to enter into the transaction;
- whether the consumer was taken advantage of as a result of physical or mental infirmity, ignorance, illiteracy, age, or inability to understand the transaction;
- whether the transaction price was far out of line with what other consumers pay in similar transactions;
- whether, at the time the transaction was entered into, there was no reasonable probability that the consumer would be able to pay the full transaction price; and
- whether the terms or conditions of the transaction were so harsh or adverse as to be inequitable.

In addition to these factors, the court in *Canmerica Mortgage Corporation v. Yu*, 2015 BCSC 773, described the common law test for determining whether a contract is unconscionable. First, the party who claims to have been taken advantage of must prove that the transaction involved both an inequality of bargaining power and substantial unfairness. Factors that the court will look at to determine whether an inequality of bargaining power existed are somewhat similar to section 8 of the Act and include: the relative intelligence and sophistication of the "weaker" party, whether the "stronger" party was aggressive in the negotiation, whether the "weaker" party sought or was advised to seek legal advice, and whether the "weaker" party was in a situation of need or distress that compelled them to enter into the contract. If this first step is proven, the burden of proof shifts to the "stronger" party to prove that the contract was fair, just, and reasonable. Another way of thinking about this is to ask whether the community would look at the transaction as a whole and consider it to be in line with the standards of commercial morality.

Another factor to note is that a high rate of interest alone is not decisive in determining whether a court will intervene in a transaction; rather, the court will look at the amount of risk borne by the lender and the potential profit. Other questions the court will look at are whether the borrower could have obtained similar financing elsewhere (and what interest rates would have been charged) and how desperate the borrower was to get the money (the more the borrower needed the money, the less bargaining power they had). If the borrowers had experience dealing with real estate financing, understood the nature of the transaction and the risks it involved, and had a substantial personal advantage to gain from obtaining the loan, then the courts will be less likely to find an unconscionable transaction took place.

Once the court has the power to intervene, it can, in effect, rewrite the whole transaction. This can include varying the amount owing, ordering repayment of money already received, or revising the terms of security already provided.

Part 5 of the Act came into force on July 1, 2006, and requires that disclosure be given by mortgage brokers and lenders to individuals who borrow for primarily personal, family, or household purposes.

Part 5 requires that a Disclosure Statement, Notice or Statement of Account, as provided in the Act, must be given to the borrower:

- two days prior to the borrower incurring an obligation under a credit agreement, unless the two-day period is waived;
- once every 12 months if the interest rate is floating;
- within 30 days of any one percent or greater increase in the interest rate for credit agreements with fixed interest rates subject to change;
- within 30 days of the borrower missing a payment or a default charge being imposed by the lender if the outstanding principal changes as a result of the default and the total amount of the payments which the borrower is scheduled to make over a payment period does not cover the interest that will accrue in the payment period;
- within 30 days after an amendment to the credit agreement;
- within 21 days prior to the end of a mortgage term, if the mortgage is being renewed; and
- every month if the loan is for open credit.

The Act does not contain prescribed disclosure forms, notices or statements of account. It does however, prescribe required content in sections 84 to 92 of the Act.

Mortgage Brokers Legislation

Most provinces have legislation to regulate persons who deal in mortgages within the province. This ensures the public feels their interests as consumers of mortgage products are protected. The British Columbia *Mortgage Brokers Act* defines a mortgage broker as a person:

- who carries on the business of lending money which is completely or partially secured by mortgages. It does not matter whether the money is the broker's own or someone else's;
- represents themselves as a mortgage broker, for example, by an advertisement or sign;
- who carries on the business of buying and selling mortgages or agreements for sale;
- who receives at least one thousand dollars per year in fees for arranging mortgages for other people;
- who makes at least ten mortgage loans in a year; or
- who carries on a business of collecting money secured by mortgages.

A sub-mortgage broker is like a representative under the *Real Estate Services Act* in some ways. They are the person who does any of the things that a mortgage broker does and is employed by a mortgage broker or is a director or a partner of a mortgage broker. Mortgage brokers and sub-mortgage brokers must be registered in the mortgage broker register, maintained by the provincial Registrar of Mortgage Brokers.

There are some exemptions from the registration requirements. These include:

- insurers licensed under the *Insurance Act*;
- banks under the *Bank Act* (Canada);
- credit unions;
- trust companies;
- a lawyer, if the loan transaction is made in the course of practice as a lawyer;
- any person acting for the government or for an agency of the government;
- a liquidator, receiver, trustee in bankruptcy, or a person acting under the authority of any court or an executor or trustee acting under the terms of a will or marriage settlement while acting as mortgage brokers or sub-mortgage brokers under their proper names;
- a person lending money, directly or indirectly, on the security of land to provide housing for employees; or
- any other people who are exempted by the registrar.

The registrar has the power to investigate any complaints regarding a breach of the *Mortgage Brokers Act*, including criminal fraud. The registrar's powers of investigation are wide and allow them to enter, inspect all books of account and other records and seize any relevant information. Authority is also given to freeze the trust funds of any mortgage broker pending the outcome of an investigation. A bond can be required from each broker. A mortgage broker who breaches the *Mortgage Brokers Act* can have their registration suspended or cancelled. The broker can also be required to pay a fine or be imprisoned, or both. Finally, an innocent party may take action against the broker to enforce any common law rights they may have.

Environmental Legislation and Mortgage Loan Application Procedures

The *Environmental Management Act* creates an exemption from remediation liability for lenders who act primarily to protect their security interests. Prior to this legislation, lenders had identified several concerns associated with existing contaminated sites provisions in the *Waste Management Act*. One such concern was the broad language used, which caused lenders to fear that they may be held liable for remediation of contaminated sites simply on account of exercising their rights as lenders. Another concern surrounded the uncertainty over what constituted a “contaminated site” and “remediation”. This produced a high degree of risk for lenders evaluating a borrower's financial viability. As well, lenders had concerns that they may be unfairly called upon to contribute financially to remediation which was made necessary by the actions of others.

The *Environmental Management Act* provides that a secured creditor (lender) is not liable if they:

- participate only in purely financial matters related to the site;
- have the capacity or ability to influence any operation at the contaminated site in a manner that would have the effect of causing or increasing contamination, but do not exercise that capacity or ability in such a manner as to cause or increase contamination;
- impose requirements on any person, if the requirements do not have a reasonable probability of causing or increasing contamination at the site (for example, lenders are allowed to insist on environmental conditions within a security agreement); or
- appoint a person to inspect or investigate a contaminated site to determine future steps or actions that the secured creditor might take.

However, there are two instances when lenders can become liable for remediation. The first is where they exercise control over or impose requirements which cause a site to become contaminated. The *Contaminated Sites Regulation* clarifies that certain types of control, including undertaking realization proceedings, do not attract liability. The second situation which can attract liability for remediation is where lenders become the registered owner of contaminated property, for example, as the result of foreclosure where the lender obtains an order absolute (discussed later). However, this exposure to liability ends once the lender disposes of (or sells) the property.

The current legislative framework provides greater certainty and fairness to all contaminated sites stakeholders. For lenders and their agents, the clarity brought by the amendments to liability issues is particularly important as it changes the loan application procedures used by banks and other financial institutions when considering whether to lend money to current or prospective owners of commercial or industrial property. The institutions may take advantage of the more transparent legislative rules to determine if the properties might be contaminated enough to attract liability for remediation.

ASSIGNMENT OF THE MORTGAGE

assignment

to transfer over to another (e.g., “I assign all right, title and interest in Blackacre to my partner, Elaine”)

The concept of *assignment* of rights under a contract was introduced in Chapter 10: “The Law of Contract”. The lender can transfer its interest in the land and its right to receive the money, without the consent of, or prior notice to, the borrower. After the assignment has taken place, and written notice of the assignment has been given to the borrower by the assignee, the assignee of the debt is then entitled to enforce the lender's rights directly against the borrower.

The assignee takes their interest subject to the state of the mortgage account between the original parties. As a result, if no money had been advanced by the lender to the borrower, the assignee would take subject to that state of accounts and would not be able to sue the borrower on the personal covenant. The assignee would have no rights against a borrower in these circumstances. Therefore, an assignee should always find out from the borrower the amount owing on any mortgage they are considering buying and, if possible, have the borrower joined (added) as a party to the assignment.

The borrower must receive notice of the assignment because until notice is received, the borrower must continue to pay the assignor rather than the assignee. The notice is the event which “freezes” the state of the accounts between the borrower and the lender and requires the borrower to make payment to the assignee.

Example

On January 1, E, a mortgage lender, assigns a mortgage worth \$200,000 to A. No notice is given to the borrower, M. On February 1, M pays E \$1,000 on the mortgage. If on February 2, M receives notice of the assignment from A, M will only be liable to A for \$199,000 even though as between A and E the date of the assignment was January 1. A, of course, can sue E for the \$1,000. On the other hand, if after receiving the notice of assignment from A on January 15, M paid E \$1,000 on February 1, M would still be liable to A for the full \$200,000. M, of course, could attempt to recover the \$1,000 paid to E, but that payment to E would not affect M's liability to A.

Example

E obtains and registers a mortgage in the amount of \$300,000 against the property of M. However, E has not yet advanced any money. If M confirms the \$300,000 debt to A, a potential assignee, (when, in fact, M owes nothing), M will be prevented from later denying the representation. If A takes an assignment on the strength of M's representation, M will be liable to A for the \$300,000.

It is the actual state of accounts between the borrower and the lender that is relevant in determining an assignee's rights against a borrower. It does not matter how much may appear to be owing under a registered mortgage. There is an exception to this rule, however, which is that when the borrower has, by conduct or statements, represented certain facts about the mortgage account to the assignee (for example, the amount owing), the borrower will not subsequently be allowed to deny the truth of those facts.

The assignee also takes subject to any right of set-off which the borrower has against the lender at the time they receive notice of the assignment. For example, where a portion of the borrower's monthly payment is paid to cover future taxes, and the actual tax bill is lower than the amount paid, the borrower may be entitled to “set-off” the overpayment from the next payment, even after receiving a notice of assignment.

Unless the lender fraudulently misrepresents the balance due on the mortgage, the lender will not be liable to the assignee if the borrower fails to repay the debt. If the assignee wants to obtain that type of protection, they must require the lender to guarantee the payment of the debt. If the lender agreed to be a guarantor, the assignee could then sue the lender if the borrower did not pay. A sample guarantor clause in a mortgage was presented earlier in this chapter. At common law, a guarantor's liability is removed if the assignee makes a material alteration in the terms of the mortgage, for example, giving the borrower an extension of time. Note that the sample clause expressly changes this rule. This is a common practice. See the section titled “Guarantor” under “Express Terms of a Mortgage” in this chapter for the sample guarantor clause.

ASSUMPTION OF THE MORTGAGE

Continuing Liability of the Original Borrower

Many lending institutions offer mortgages which can be assumed by future buyers, with or without qualification. These *assumable mortgages* are attractive to many buyers. However, certain court decisions have made it clear that the original borrower may remain liable on the personal covenant if the buyer who assumes the mortgage defaults on their payment. Sometimes the original borrower may not be advised of defaults in payment until long after they occur.

assumable mortgage

a mortgage that allows a buyer to assume or take over the responsibilities and liabilities under the mortgage from the seller (original borrower)

Example

A purchases Whiteacre for \$100,000 and finances the purchase by means of a mortgage of \$90,000 with a two-year term. The lender agrees that the \$90,000 mortgage can be assumed by any future buyer. Later, A sells Whiteacre to B, who agrees to assume the mortgage. The lender is advised that B has assumed the mortgage. Six months later, B becomes unemployed and defaults on the mortgage payments. A year later, after giving B numerous extensions, the lender starts court proceedings to recover the debt. The amount outstanding on the mortgage is now \$120,000 as a result of the delays, accrual of interest, etc. Whiteacre's value is now \$90,000 because of a decline in prices. The lender is able to obtain judgment against A for the mortgage debt. The property is sold by judicial sale, and after commission, taxes, etc., are paid, the lender is still owed \$40,000. The lender may enforce its judgment against A to recover the \$40,000 deficiency.

It is important for sellers to understand the risks of allowing a buyer to assume a mortgage. Special caution is necessary where the buyer is a limited liability company, which may have no assets, or where the purchase involves a revenue-producing property but the buyer has no independent source of income from which to make payments.

When a borrower transfers their interest in a property to a buyer who assumes the mortgage, the borrower will usually require the buyer to sign an agreement promising to make all the necessary payments to the lender. In addition, the buyer will usually promise to reimburse the borrower if the lender starts a court action against the borrower on their personal covenant. Even without such an agreement, the *Property Law Act* will imply these promises unless the parties specifically exclude them in their agreement. However, even though the buyer signs the agreement, the liability of the original borrower on their personal covenant may continue. If the buyer defaults, the promise to reimburse the borrower is worth very little if the buyer has no money.

Direct Action by a Lender Against a Current Owner

Under contract law principles (the doctrine of privity of contract) it would not be possible for a lender to sue a buyer who assumes a seller's mortgage under the covenant to pay contained in the mortgage. This is because the buyer assuming the mortgage was not a party to the original agreement, which therefore cannot be enforced against them.

However, the *Property Law Act* provides for the right of a lender to maintain a direct action against a buyer who has assumed the mortgage or taken over a seller's interest under an agreement for sale. This right is available to all lenders, regardless of the purpose of the loan (i.e., it does not matter if the loan is for a residential or other purpose). This means that where a seller sells property subject to a mortgage which is assumed by the buyer, if the buyer defaults, the lender is allowed to sue the buyer directly to recover the debt just as if the buyer were a party to the mortgage between the lender and the seller (original borrower).

Example

Bob buys a house and grants a mortgage to Elaine to finance the purchase. Bob later sells the house to Whitney who assumes Bob's mortgage. Subsequently Whitney defaults under the mortgage. At common law, Elaine would be unable to sue Whitney. However, the *Property Law Act* changes that rule and allows Elaine to sue Whitney directly as if Whitney were a party to the original mortgage contract between Elaine and Bob.

Limitation of a Vendor's Liability Under the *Property Law Act*

The *Property Law Act* limits the vendor's liability to the lender where the vendor sells property subject to a mortgage or an agreement for sale to a purchaser who assumes the vendor's mortgage or to whom the vendor's interest under an agreement for sale is transferred.

There are restrictions to the application of the *Property Law Act* protection. In the first place, the loan (either the mortgage or the agreement for sale) must be for a “residential purpose”. This means the loan must be either:

- to acquire the residence;
- to make improvements to the residence;
- to make expenditures for a household or family purpose; or
- to refinance for one of the above three purposes.

If the purpose of the loan for which the property is security is not for one of the above four purposes, then the *Property Law Act* protection will not be available. For example, if a businesswoman were to borrow money for the purposes of her business and used her house as security by way of a mortgage, she would not be able to claim the *Property Law Act* protection if she sold the house to a purchaser who assumes the mortgage.

The *Property Law Act* limits the continuing liability of a vendor under a mortgage or agreement of sale in the following circumstances:

- Where a lender expressly approves in writing a purchaser’s assumption of the mortgage or agreement for sale, then the vendor’s liability will cease. The lender is not allowed to withhold its approval unreasonably, subject to the following requirements:
 - the request for it must be made within 3 months of the transfer; and
 - the lender is entitled to reasonable financial information about the purchaser and may claim reasonable expenses for obtaining a credit report and handling costs.

If a lender does unreasonably refuse to approve a purchaser, the vendor may seek a court order approving the purchaser and extinguishing the vendor’s personal liability.

- Where the term of the mortgage has expired and the lender does not make a demand for payment within 3 months of the expiry, then the assignor of the mortgage or agreement for sale will no longer be liable under the mortgage or agreement for sale.

Example

On September 1, 2010, Betty mortgages her house as a means of financing its purchase. The mortgage term is five years terminating on August 1, 2015. On August 1, 2013, Betty sells her house to Amanda who assumes Betty’s mortgage. By November 1, 2015, if the lender has not demanded that Betty pay the amount outstanding, Betty’s liability under the mortgage will be extinguished. The lender’s only recourse may be to pursue Amanda for the amount outstanding.

- Where the mortgage assumed or agreement for sale transferred is payable upon demand, then if the lender doesn’t demand payment from the vendor within 3 months of receiving notice of the assumption of mortgage or transfer of agreement for sale, the vendor’s liability will be extinguished. The lender’s only recourse may be to pursue the purchaser for the amount outstanding.

Upon selling a residential property subject to a mortgage or agreement for sale, the vendor will want to be released immediately from any continuing liability in respect of a property which they no longer own. A licensee acting for a vendor should be aware of the risks posed when a purchaser assumes a vendor’s mortgage or agreement for sale prior to agreeing to the assumption. Since the licensee will usually be the person who drafts the contract of purchase and sale (and will be liable if it is done negligently), where an assumption is involved, the licensee must draft the contract of purchase and sale so as to adequately protect the vendor.



As a Licensee...

Where a buyer intends to assume the seller's mortgage, a licensee should include in the contract of purchase and sale a clause similar to the following:

ASSUMPTION OF EXISTING MORTGAGE CLAUSE

The Buyer will pay to the Seller \$ (amount) , (approximately) which includes the Deposit, on the Completion Date, as part payment of the Purchase Price.

The balance of the Purchase Price will be paid by the Buyer assuming all obligations under the existing (rank) mortgage registered in the name of (name of lender) (the "Lender") with an outstanding balance of approximately \$ (amount) , which provides for:

- a. interest rate of % per annum, calculated (annually/semi-annually/monthly), not in advance;
- b. end of term of (date); and
- c. blended monthly payments of \$ (amount) including principal and interest (plus 1/12 of the annual taxes, if required by the Lender).

Subject to the Lender, pursuant to section 24 of the *Property Law Act*, approving the Buyer in writing on or before (date), thereby releasing the Seller from liability under section 24(1) of the *Property Law Act*.

This condition is for the benefit of both the Buyer and the Seller.

Source: "Clauses" section in BC Financial Services Authority's (BCFSAs) Knowledge Base, found online.

NOVATION

If the *Property Law Act* does not apply to extinguish continuing liability to a lender, another circumstance in which a borrower or guarantor of mortgage debt will be released from the mortgage debt is where novation occurs. With a novation, the original borrower and/or guarantor will be released from further liability. The doctrine of novation applies to any type of mortgage or agreement for sale, so its scope is broader than the *Property Law Act* sections which are limited to residential mortgages or agreements for sale. A novation is the substitution of one contract for another. In the context of assumptions of mortgages or agreements for sale, this means that the original contract between the lender and the seller is replaced by a new contract between the lender and the buyer. Where a lender approved the assumption and subsequently enters into a renewal of the mortgage with the buyer a court will be likely to find that a novation has occurred, releasing the original borrower (the seller) from any further liability under the mortgage. The courts in British Columbia have stated three principles required to establish novation of a mortgage:

- a. The new borrower must assume complete liability;
- b. The lender must accept the new borrower as a principal debtor and not merely as an agent or guarantor;
- c. The lender must accept the new contract in full satisfaction and substitution for the old contract.

PRIORITIES

Competing Mortgages

In British Columbia, priority among charge holders usually depends upon order of registration in the land title office. The date the mortgage contract is made or the lender advances funds is not the relevant date when determining priority.

Example

A obtains a loan on January 1st from B and grants B a mortgage as security. On January 2nd, A obtains a second loan from C and grants C a mortgage on the same property. If C applies in the land title office to register the mortgage before B does, C will become the first mortgagee and B will hold the second mortgage.

However, where a mortgage expressly states that it is subject to another mortgage, the other mortgage will have priority even if registered later in time. Most second or third mortgages will have such a clause. Charge holders may also agree among themselves regarding priority by registering priority agreements on title to the

property which have the effect of changing the order of priority that was based on time of registration. Which mortgage has priority is very important to the lender, because the higher priority a mortgage has, the better security it provides.

Redeem Up, Foreclose Down

Refer to the interests set out in Figure 15.2 below. Note that Blackacre has a fair market value of \$100,000. The registered owner has received loans of \$50,000, \$25,000, \$10,000 and \$5,000, each secured by a mortgage.

Foreclosure by the First Mortgage Lender

If you refer to the title search at Appendix 4.2 of Chapter 4, you will see that the borrower's name is placed at the top as "owner" of the fee simple interest. To understand mortgage priorities, it is better to place the borrower at the bottom of the list as in Figure 15.2. The person with first priority is the first mortgage lender. If the payments on the first mortgage are not made, the first mortgage lender has the right to foreclose. If the first mortgage lender is granted an order absolute of *foreclosure* by the court, they "foreclose," or remove from the title, all interests which rank below the first mortgage. Foreclosure by the first mortgage lender would not occur in this particular case (where the property value exceeds the total mortgage secured) because one of the other mortgage lenders or the borrower would ask the court to have the property sold and have the proceeds of the sale divided among them.

foreclosure

a legal action taken by a mortgagee to realize on its security, by reason of the mortgagor's default on the mortgage

Foreclosure by the Fourth Mortgage Lender

If payments on the fourth mortgage are not made, the result is a little different. The only person the fourth mortgage lender can foreclose is the borrower. This is because only the borrower has lower priority than the fourth mortgage lender in this example. The first, second and third mortgage lenders are not concerned about a foreclosure by the fourth. If the fourth mortgage lender obtains an order absolute, they remove the borrower from the title and therefore become the fee simple owner, subject to the first, second and third mortgages. Again, it is unlikely that this would happen in this case because there is some equity in the property. The borrower could probably raise the amount owing on the fourth mortgage from another lender and pay it out. A new fourth mortgage charge would replace the old one on title to Blackacre.

Redemption by the Borrower

In most cases, the borrower will make the required payments. Once the borrower pays the amount owing on the fourth mortgage, they can redeem it. The fourth mortgage lender will provide a discharge of the mortgage, which can be registered in the land title office. The discharge removes the mortgage from the title. The borrower can then redeem the third, second and first mortgages. Once all mortgages are paid out, the borrower will have redeemed the legal title to Blackacre free and clear of all charges.

FIGURE 15.2: Mortgage on Blackacre with Market Value of \$100,000

Registration on Title	Amount of Loan	Interest Held in Land
First Mortgage	\$50,000 secured by first mortgage	A mortgage of the fee simple interest in Blackacre and the right to the legal title to Blackacre as security for the loan
Second Mortgage	\$25,000 secured by second mortgage	A mortgage of the equity of redemption and the right to redeem the first mortgage
Third Mortgage	\$10,000 secured by third mortgage	A mortgage of the equity of redemption and the right to redeem the second mortgage, and then the first mortgage
Fourth Mortgage	\$5,000 secured by fourth mortgage	A mortgage of the equity of redemption and the right to redeem the third mortgage, then the second mortgage, and then the first mortgage
Registered Owner	N/A	Registered owner of the fee simple interest and owner of equity of redemption (value of approx. \$10,000)

FURTHER ADVANCES

Description

Recall that a mortgage can provide that advances of money secured by the mortgage will be made by the lender to the borrower over a period of time. For example, where a builder is constructing a house on a lot, they may wish to borrow \$100,000 to do so. The builder would secure this loan by a mortgage registered against the lot. However, since the builder does not need the money all at once and the lender does not want to risk advancing the entire amount of money for work not yet completed, the lender and builder can negotiate a mortgage payable in advances. In this case, the face value of the mortgage will be \$100,000, but the mortgage money will be advanced in stages: for example, \$25,000 immediately; \$25,000 after the foundation is in; \$25,000 when the frame is completed; and \$25,000 after the occupancy permit is issued.

Priorities

Because having first priority is important, the first mortgage lender who has agreed to make further advances must be sure to maintain its priority respecting those advances.

Example

ABC Loan Company has agreed to lend Better Builders Co. \$100,000 in exchange for a mortgage on Better Builders' lot. Better Builders plans to build a small commercial building on the lot and needs the \$100,000 to finance the project. ABC agrees to 4 equal instalments of \$25,000. On the day ABC registers as first mortgagee, it advances \$25,000. A month later, XYZ Ltd. registers as second mortgagee, having loaned Better Builders \$15,000. Two months after that, it is time for ABC Ltd. to advance the next \$25,000. If ABC advances the money, does it have priority over XYZ for the full \$50,000 or only for \$25,000?

The answer is that a first mortgage lender keeps its priority in three cases:

- If it has received no written notice of the second mortgage in the prescribed manner under the *Property Law Act*;
- If its mortgage agreement contractually requires it to make the future advance. Remember that most standard mortgages do not do this – there is usually a clause stating that the lender has no obligation to advance any money; or
- If it has received a “priority” or “postponement” agreement from the second mortgage lender. In practice, this is the most common approach. A new mortgage is drawn for the total of the balance owing under the existing first mortgage plus the amount of the new advance, with the second mortgage lender joining as a third party agreeing to give the new mortgage priority over its subsequent mortgage.

The first option needs some explanation. If the second mortgage lender gives written notice, in the prescribed manner and form, to the first mortgage lender when the second mortgage is registered, the first lender loses priority with respect to any subsequent advances. Oral notice is not sufficient. Therefore, in the above example, if XYZ had given written notice to ABC, unless ABC was contractually obligated to pay the second instalment, ABC would not have priority for the full \$50,000. Because a lender who receives written notice would not advance further funds, the borrower would have to get the second lender to grant a priority agreement to the first lender if the borrower needed the further funds.

Statutory Priorities

A mortgage lender can lose its priority over certain other charges even though the mortgage was registered first. Therefore, these charges can impact a potential borrower's ability to obtain financing. Remember that a common mortgage clause (discussed earlier) permits a lender to refuse any advancement for any reason whatsoever. It is important for a lender to check the title of the property for any of these charges before advancing funds. Some examples are discussed below.

Builders Lien Act. Builders liens can be filed against title to a property by contractors, subcontractors, and workers with respect to a debt arising from labour, services, or materials provided for an “improvement” to the property. The *Builders Lien Act* gives priority to the lien over a mortgage as of the date the lien is filed in the Land Title Office. Therefore, the lien claimant has priority over any advances made by a registered mortgage lender after that date.

Employment Standards Act. The Director of Employment Standards has the power under the *Employment Standards Act* to issue a certificate to any employee who has wages owing from an employer. This wage claim certificate can be registered in the Land Title Office against any land owned by the employer, and constitutes

a lien, charge and secured debt in favour of the Director of Employment Standards. This lien has priority over all liens, judgments, charges or any other claims or rights, including those of the Crown. However, there is an exception. Money advanced under a mortgage registered in the Land Title Office before the certificate is registered will have priority over the wage claim.

Local Government Act/Community Charter. Unpaid property taxes and other fees and charges owing to a municipal government constitute liens against property. These statutes provide that these liens have priority over any other claim, lien, privilege or charge of any person except the Crown. Additionally, any lien under these statutes does not need to be registered in the Land Title Office in order to have priority over a mortgage. For property outside the jurisdiction of the *Local Government Act*, there is a similar provision in the *Taxation (Rural Area) Act*. Property tax information is generally public information and can be downloaded from BC Online.

After property taxes remain unpaid to the municipality for a period of three years, or two years in the case of rural properties, the property will be sold by the municipality at a tax sale. The registered owner or mortgagee can redeem the property within one year from the date of sale by paying the specified redemption amount. If the property is not redeemed during this time period, title is transferred to the tax sale buyer free and clear of all charges.

Strata Property Act. If the owner of a strata lot fails to pay the strata corporation their share of strata fees, a special levy or a judgment against the strata corporation, the strata corporation has the right to register a lien in the Land Title Office against the strata lot. The *Strata Property Act* provides that the strata corporation's lien ranks in priority to every other lien or registered charge, including a mortgage, except a lien in favour of the Crown or a lien under the *Builders Lien Act*. Fines and penalties owed by an owner of a strata lot to the strata corporation do not form part of the lien and do not have priority over other registered charges.

Workers Compensation Act. Under the *Workers Compensation Act*, employees can make claims for work-related injuries and receive compensation from an insurance fund. Unpaid fines or insurance fees due to the Workers Compensation Board from an employer constitute a lien against land owned by the employer. This lien takes priority over all liens, charges or mortgages, except liens for wages due to workers by the employer.

Deemed Trust Claims under the federal Income Tax Act, Canada Pension Plan, Employment Insurance Act, and Excise Tax Act. Where a taxpayer fails to remit sales tax as required by the *Excise Tax Act*, source deductions as required by the *Income Tax Act*, or an employee's contribution or premium withheld through payroll deductions as required by the *Employment Insurance Act* and *Canada Pension Plan Regulations*, these unremitted amounts are deemed to be held separate and apart from the taxpayer's property, in trust for the Canada Revenue Agency (CRA). The deemed trust amounts attach to the property of the taxpayer and rank in priority above all security interests in the property, except with respect to prescribed security interests (PSI) held by secured creditors. The way to calculate a PSI can be complex, but a simple way of describing the calculation is to begin with the mortgage balance on the date of the failure to remit and subtract all payments made by the debtor to the secured creditor after that date.

A deemed trust can be claimed by the CRA years after the property has been sold and the creditor has been paid on its security, resulting in a creditor having to pay out of pocket to return the deemed trust amounts to the CRA.

There is no searchable registry or other effective means of determining if a borrower owes money to the CRA that forms part of a deemed trust claim. With the consent of the borrower, a lender could make inquiries to the CRA (for example, as part of a credit application) to determine whether the CRA is aware of any deemed trust claims outstanding.

THE FORECLOSURE PROCESS IN BRITISH COLUMBIA

Description

The purpose of a foreclosure proceeding in British Columbia is two-fold: (1) to extinguish the borrower's equitable right to redeem; and (2) to allow the lender to realize on its security. Because the borrower has defaulted, the legal or contractual right to redeem is already extinguished.

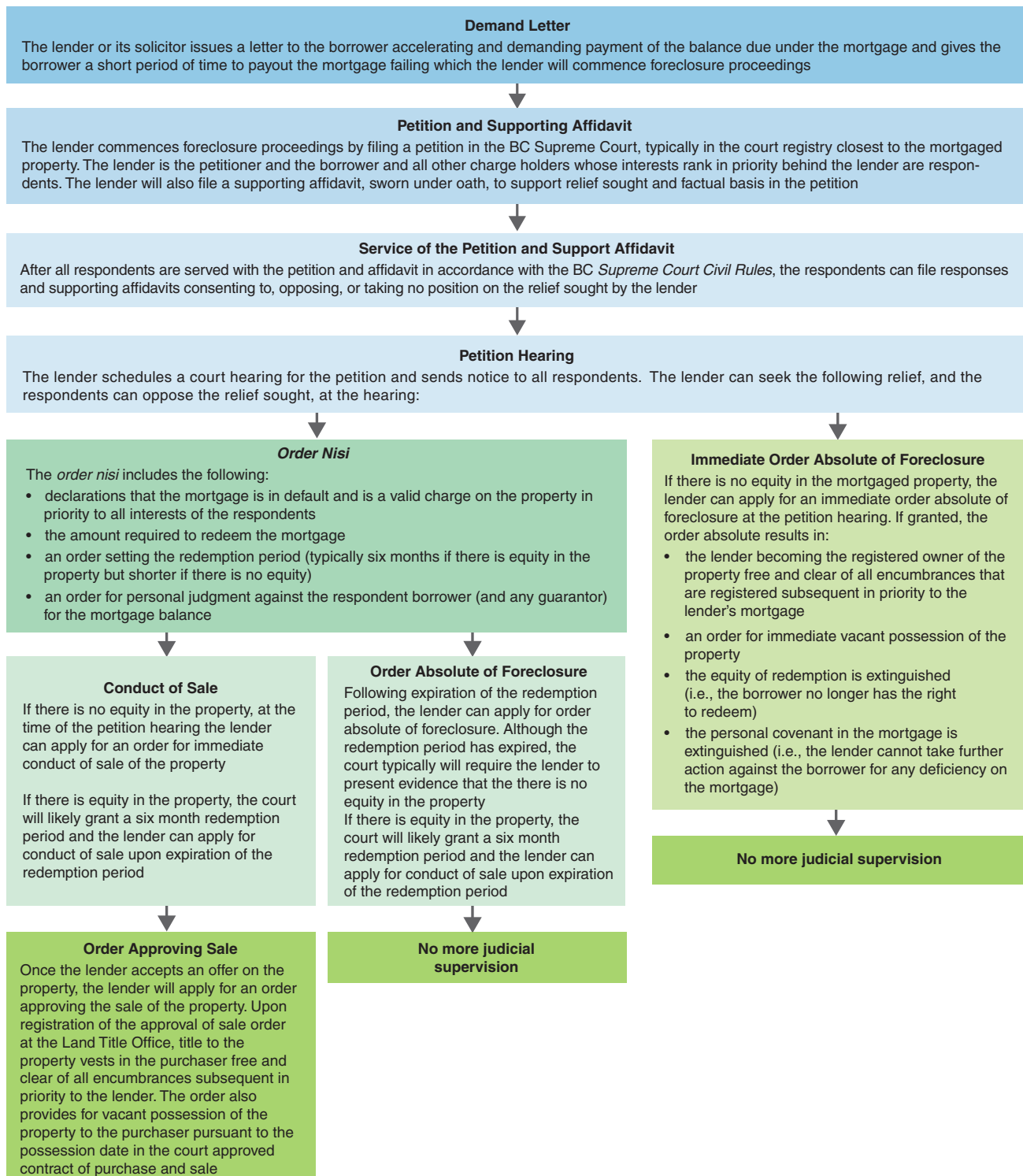
FIGURE 15.3: Steps in a Typical Foreclosure Proceeding

Figure 15.3 shows the typical steps in a foreclosure proceeding. There is no set time-frame for the foreclosure process in British Columbia. Factors that can increase or decrease the time that it takes for a lender to complete foreclosure include: (1) the time it takes to serve all respondents in the proceeding; (2) availability of court dates; (3) the length of the redemption period and any extension of the redemption period; and (4) the time it takes for the lender to sell the property (if the lender pursues the judicial sale process).



ALERT

Licensees who have limited experience in foreclosure transactions should seek guidance from their managing broker. This is a complex area of real estate where unforeseen hurdles can cause serious problems for the licensees and the public. Local real estate boards offer courses throughout the year related to foreclosures and court ordered sales. See “Make Sure You Don’t ‘Foreclose’ on Your Duties to Your Client” in the June 2014 Report From Council which can be accessed in BCFSAs Knowledge Base.

Prior to commencing foreclosure proceedings, the lender or its solicitors will issue a demand letter to all borrowers and guarantors which notifies them of the default, accelerates the balance due under the mortgage, and demands payment in full thereof. A period of a week or two is typically given for payment. At this stage, a lender will also confirm whether the property is an investment property or used for business purposes, in which case notice under section 244 of the *Bankruptcy and Insolvency Act* should be given prior to commencing foreclosure proceedings. This section requires that a secured creditor (e.g., a mortgagee) who intends to enforce a security (e.g., a mortgage) of an insolvent person, must provide notice in the prescribed form and must not enforce the security (e.g., commence foreclosure proceedings) before ten days has elapsed.

Another important statute a lender will consider is the *Farm Debt Mediation Act*. If the borrower is a farmer (defined very broadly in the *Farm Debt Mediation Act*), a lender who intends to enforce the security of the farmer must give notice of this intention to the farmer in the prescribed form and must wait 15 business days before enforcing the security. The Court of Appeal in British Columbia has held in several cases that failure to provide proper notice to a farmer prior to commencing foreclosure as required by the *Farm Debt Mediation Act* will render the entire foreclosure proceeding null and void.

Following expiration of the period set out in the demand letter, the lender will commence foreclosure proceedings. In British Columbia, foreclosure proceedings are commenced by a document called a petition. The petition sets out the relief sought by the lender (petitioner) and the factual basis for the relief. The petition is filed in the Supreme Court of British Columbia, typically in the court registry closest to the property (as required by the *Law and Equity Act*). The lender will also file a supporting affidavit, sworn under oath, to support the factual basis and relief sought in the petition.

The Respondents. The lender must name as respondents in the petition all persons whose interest or claim to the mortgaged property is sought to be extinguished and against whom any relief is sought. All persons whose interests appear after the petitioner’s on title to the property at the time the action is commenced will be named as respondents in the petition.

If the property is occupied by residential tenant(s), the *Residential Tenancy Act* requires that the lender name each tenant as a respondent if the lender wishes to enforce an order for vacant possession of the property against the tenant(s) once it is sold. Provided that this is done, the tenant(s) will be required to immediately vacate the property once the court makes an order for vacant possession, even if the tenancy agreement stipulates a later expiry date and even if the tenant(s) are not given the notice otherwise required by the *Residential Tenancy Act*.

Relief Sought. The relief a lender usually seeks in a foreclosure proceeding is as follows:

- *a declaration that the mortgage is a valid mortgage charging the property in priority to all respondents and that the mortgage is in default;*

The respondents can appear at the hearing of the petition to challenge the validity of the mortgage or the lender’s claim that the mortgage is in default, and they can raise priority issues among charge holders.

- *an order that the redemption period be set;*

The redemption period is the time the court sets for the respondents to redeem (payout) the mortgage. If there is equity in the property, the court will typically set a six-month redemption period. If the lender produces evidence that there is no equity in the property or the property is abandoned or subject to waste, the court will set a shorter redemption period, in some cases for one day.

- *an accounting of all monies owing under the mortgage;*

The court will review the loan agreement and the lender's evidence of the amount owing under the mortgage, and will confirm the amount owing. The court will also confirm the rate of interest that will continue to accrue on the mortgage on a per diem basis during the redemption period.

- *judgment on any personal covenants in the mortgage for the amount found to be due;*

Unless the borrower or other party liable for the mortgage debt has made an assignment in bankruptcy, the lender will seek an order for personal judgment for the mortgage debt against the borrower, any guarantor of the mortgage, and any other party who may be liable for the mortgage debt. If the lender later sells the mortgaged property for a price that is insufficient to pay the mortgage debt in full, the lender can pursue the judgment debtor for the deficiency. A lender can pursue an order for personal judgment in a separate action against the borrower or other liable party, but the order is typically sought in the foreclosure proceeding for efficiency.

- *the appointment of a receiver;*

If the mortgaged property has been abandoned or contains a commercial operation, (e.g., an apartment building, or a single family residence used as a revenue producing property by the borrower), the lender may request that the court appoint a receiver. The receiver's job is to collect the rents, pay the bills, and generally keep the business going. The receiver is accountable to the court for their actions and the receiver's fee will be added to the amount outstanding under the mortgage.

- *possession of the property;*

This order is typically sought in connection with an order absolute of foreclosure or order approving the sale of the property. In cases where the borrower or occupants of a property are causing damage to the property or refusing to allow the lender to list and market the property in accordance with an order for conduct of sale, the lender may also apply for possession of the property. If a vacant possession order is granted, the borrower and all occupants will be required to immediately vacate. If they refuse, the lender can obtain a writ of possession and the court bailiff will evict the borrower and occupants.

- *certificate of pending litigation;*

In Chapter 4, this type of notice was mentioned in reference to the discussion of caveats. A certificate of pending litigation can be registered in the land title office to indicate that legal action is pending against the property. In a foreclosure proceeding, a certificate of pending litigation is normally filed at the time the petition is filed.

- *costs of the proceeding;*

Court costs were explained in Chapter 1. Although a mortgage agreement may provide that all legal expenses incurred by the lender are recoverable when enforcing a mortgage, the case law in British Columbia and *Law and Equity Act* has restricted this recovery.

The Court Proceedings

Order Nisi

After the petition and supporting affidavit are served on all respondents, the lender will set a hearing on the petition. At the hearing, the lender can request that the court grant *order nisi* of foreclosure. The *order nisi* will grant the relief outlined above and will fix the redemption period. An *order nisi* is considered to be a

order nisi

a final order of the court in the foreclosure process which may not be challenged except by way of appeal

final order of the court and may not be challenged except by way of appeal. Even after an *order nisi* has been granted, the owner can still hire a licensee and attempt to sell the property during the redemption period. During the redemption period, a borrower is free to list and market the property without judicial supervision.

Order for Conduct of Sale (Judicial Sale)

At the petition hearing, if the court grants a shortened redemption period, the lender will typically request an order for immediate conduct of sale of the property. If the court grants a longer redemption period, the lender will have to wait until the redemption period is close to its expiry date before applying to court for an order for conduct of sale. During a longer redemption period, a subsequent charge holder (e.g., second mortgagee or judgment holder) may also apply for conduct of sale. Whether there will be an order for immediate conduct of sale of the property or a longer redemption period will depend on whether the lender can prove that the property is worth less than the amount owing on the mortgage. If they can do so, the lender can seek order absolute at the hearing of the petition in lieu of the *order nisi* (also known as an immediate order absolute). If they can only prove that the borrower failed to pay the amount required to redeem the mortgage, the order absolute will be granted following expiration of the redemption period that was set in the *order nisi*.

The order for conduct of sale allows the lender the exclusive right to list the property on the Multiple Listing Service and to market the property for sale. Once the court grants conduct of sale to the lender, the borrower's right to list and market the property is lost, and any existing listing agreement is terminated. The order typically requires the borrower and all occupants of the property to allow the lender and its agents access to the property seven days a week during specified hours for the purpose of appraising, inspecting, and marketing the property. Any sale of the property pursuant to an order for conduct of sale is subject to court approval.



As a Licensee...

If you represent an owner whose property is under foreclosure, you should not assume that your client can no longer sell the property. Once you become aware of the foreclosure, you should contact the lender's lawyer to confirm what stage the proceedings are at and what orders have been granted. If an order for conduct of sale or order absolute has not yet been granted, the borrower continues to have the right to sell the property. In particular, if an *order nisi* has been granted, you should confirm the length of the redemption period, which is the amount of time your client has to sell the property and redeem (pay out) the mortgage.

Keep in mind that a property subject to foreclosure may have subsequent mortgages, judgments, or other liens registered on title. Each of these lien holders may have also commenced their own foreclosure or enforcement proceedings. It is important that you review a title search with your client prior to your client entering into an unconditional contract for purchase and sale to ensure that your client will be able to deliver to the buyer clear title in accordance with the contract.

On the other hand, if you are representing a lender who has commenced foreclosure proceedings and has an order for conduct of sale, you can advise the lender to maintain insurance on and to keep up with repairs and maintenance of the property to ensure that the property can show well during the proceedings. The lender can apply to the court to recover the payments made by adding the costs to the mortgage balance as "protective disbursements," so long as the costs and measures taken were reasonable in the circumstances and were necessary to protect the property.

If you represent a buyer who is interested in a property under foreclosure, you must take steps to determine the relevant court dates and not rely on simply waiting for the listing agent to inform you of the court dates. The former Real Estate Council of British Columbia reported that a number of buyers' agents did the latter and their clients were not apprised of court dates. The buyers subsequently missed the opportunity to submit competing offers.

Order Approving Sale

Once the lender accepts an offer on the property pursuant to a conduct of sale order, the contract of purchase and sale will be subject to court approval and the lender must apply to court to have the sale approved. In determining whether to approve the sale, the court looks at whether the sale price is fair and reflects the market value of the property. In support of the application, the lender will include a description of the marketing efforts and listing history as well as an appraisal of the property. At the hearing, the sale can be challenged by any of the respondents if they believe that the lender has sold the property for an amount below market value.



As a Licensee...

If you are the listing agent for the lender on a court-ordered sale of a property in a foreclosure proceeding, you must be prepared to assist the lender in providing evidence on application to the court to support the sale price. The lender will typically require that the licensee prepare a marketing report letter which sets out the length of time the property was listed, the various marketing efforts the licensee undertook, the number of showings, any issues with the property, and the current market conditions in the area. The lender may also require that the licensee attend the court hearing for approval of sale to assist the lender's lawyer. On occasion, particularly when the sale is opposed by the borrower or another party, a licensee may be called by the court to the witness stand to provide additional information regarding the listing and sale.

The primary purpose of the judicial sale process is to maximize the recovery for the lender and all respondents, including the borrower. As a result, after the lender accepts an offer on the property, the lender will instruct the listing agent to notify all previously interested parties of the sale price and to continue to market the property until the approval of sale hearing in hopes of soliciting competing offers at the hearing. On the day of the hearing, interested parties are given one chance to submit a competing offer in a sealed envelope that must be higher than the initial offer accepted by the lender. The court will open up all competing offers and will typically approve the sale to the buyer offering the highest purchase price. The lender's lawyer will instruct the licensee to ensure that all offers include a Schedule "A", which will contain the particular lender's preferred terms for sale.



As a Licensee...

Licensees should be aware that the sale of a property that is under foreclosure will require amending many standard clauses in a Contract of Purchase and Sale. For example, the Schedule to a Contract of Purchase and Sale may provide that the buyer is purchasing the property on an "as is, where is" basis. Offers to purchase property should be subject to court approval and licensees should know that a listing may be voided by a court order at any time. For more information, see the discussion about foreclosures in BCFSAs Knowledge Base.

The order approving sale will typically confirm the purchase price, the buyers, a direction to the land title office to transfer title to the buyers free and clear of all charges, and an order granting vacant possession of the property to the buyers on the possession date specified in the contract of purchase and sale. Once the court approves a sale, the borrower's right to redeem is extinguished.

The order also includes a provision regarding distribution of the sale proceeds. Typically, the order directs that the purchase price be paid to the lender's lawyers in trust, and distributed in the following manner:

- firstly, in payment of any outstanding property taxes and utilities;
- secondly (if the property is a strata lot), in payment of any outstanding strata fees having statutory priority over the mortgage;
- thirdly, in payment of real estate commissions;
- fourthly, in payment of the petitioner's mortgage plus court costs; and
- fifthly, into court to the credit of the foreclosure proceeding.

After the sale completes and the lender's lawyer pays any surplus funds into court, respondents who have an interest in the property, such as the registered owners or subsequent mortgage and judgment holders, can make a court application for payment out of court. Alternatively, a respondent can appear at the approval of sale hearing to request that any surplus funds after the first mortgage is paid in full be paid to the respondent or in accordance with an agreement among the other respondents. In the event there is a deficiency of funds after a judicial sale, the respondent is liable for that deficiency. Where a foreclosure (rather than a judicial sale) takes place, the respondent is not liable for any deficiency of funds (more later in the section on Order Absolute of Foreclosure).



As a Licensee...

If you represent a buyer on a court-ordered sale of a property in a foreclosure proceeding, you must ensure that your client is made aware of the various risks involved in purchasing such a property. One of the biggest risks is that the property is being purchased “as-is where is.” This means that the buyer is liable for the state that the property is in at the time of completion of the sale, regardless of how the property looked when it was initially viewed by the buyer. This is a significant risk, as a property under foreclosure is often occupied by disgruntled borrowers and/or tenants. A prudent licensee will ensure that the buyer takes steps to mitigate the risk of purchasing the property as is where is by obtaining a property insurance policy effective as of the date the contract of purchase and sale becomes unconditional.

Order Absolute of Foreclosure

As mentioned above, the lender can seek order absolute either at the hearing of the petition in lieu of an *order nisi* or following the expiration of the redemption period that was set in the *order nisi*. In the first case, the lender must prove, among other things, that the property is worth less than the amount owing on the mortgage. In the second case, the lender must prove that the borrower failed to pay the amount required to redeem the mortgage.

The order absolute declares that the respondents are foreclosed of any right, title, or interest in the mortgaged property, extinguishes the right of redemption, and directs them to deliver up possession of the property to the petitioner. Once the order is pronounced, the foreclosure proceedings are concluded.

After the court grants order absolute, the lender can apply at the land title office for a certificate of indefeasible title in the lender's name. Property transfer tax will be payable in connection with the transfer. Once title to the property has been transferred to the lender, no further court proceedings are required and there is no requirement to account to the borrower for any money received or any profit which might be realized in excess of the mortgage debt.

According to section 32 of the *Property Law Act*, when a lender is granted an order absolute of foreclosure, the right to sue the borrower or guarantor on the personal covenant in the mortgage or enforce a previously obtained judgment for the mortgage debt is lost. This means that the lender will not be able to recover from the borrower or guarantor any shortfall between the sale of the property and the remaining amount owing on the mortgage.

Why might a lender choose to apply for order absolute? There are several reasons:

First, a lender may wish to take title to the property where significant repairs and remediation need to be made and the lender does not want to seek an order appointing a receiver, which would add significant costs to the proceeding. Once the lender obtains order absolute and title is transferred to the lender, it is free to deal with the property without judicial supervision.

Second, if the mortgage is insured by Canada Mortgage and Housing Corporation or a private mortgage insurer and the borrower is bankrupt, the insurer may require the lender to obtain order absolute and then transfer the property to the insurer before paying the lender on its mortgage insurance claim.

Third, the lender may wish to take title and rent out the property or sit on it while waiting for market conditions to improve before listing the property for sale.

Note that when a lender is considering whether to apply for order absolute, the lender will often look at the borrower's financial status to determine the borrower's ability to repay the deficiency. If it is unlikely the borrower will be able to pay (i.e., the borrower is “judgment proof”) or if the borrower is bankrupt, then the lender is not taking a risk by losing the personal covenant once order absolute is granted.

AGREEMENTS FOR SALE

Description

If the buyer cannot pay cash for the property, they will normally arrange a mortgage loan with a third party or with the seller. This mortgage is then registered as a charge against the title. An alternative to the transfer and mortgage arrangement is to purchase the property under an *agreement for sale*. It is an agreement under which the seller

agreement for sale

a contract by which the owner of land (seller) agrees to sell land to another (buyer) who agrees to buy it. The buyer's interest is registered in the land title office as a charge against the seller's certificate of title. The contract provides that the purchase price will be paid by instalments

agrees to sell real property to the buyer on credit terms. Under most agreements for sale, the buyer agrees to pay the purchase price in a particular manner, usually a down payment plus monthly payments of principal and interest. In exchange for the buyer's promises, the seller grants possession of the property to the buyer immediately and promises to execute a freehold transfer as soon as the final payment towards the purchase price is made.

Financially, there is no difference between the seller selling by way of agreement for sale or selling the fee simple and "taking back" a mortgage. Legally, however, under an agreement for sale, the seller remains on the title as registered owner, and the *agreement for sale* is registered as a charge against the title. In a vendor "take-back" mortgage, the fee simple is transferred to the buyer, and the seller's mortgage is registered as a charge.

An agreement for sale (referred to in land titles offices as a "right to purchase" or "RP") must be registered in the land title office using Form C of the land title forms. Below is an example of what a right to purchase charge would look like on a title search.

Sample:	Nature:	RIGHT TO PURCHASE
	Registration Number:	CA7779999
	Registration Date and Time:	2014-09-18 12:49
	Registered Owner:	JANE SMITH

Remedies

Essentially, the remedies under an agreement for sale parallel those under a mortgage agreement. A vendor under an agreement for sale commences a court action and usually seeks an order for specific performance of the agreement or cancellation of the agreement and forfeiture of all the monies paid under it. As with a mortgage foreclosure, the court first grants an *order nisi* and sets a "redemption" period (usually 6 months). The petitioner/vendor can also apply for a judicial sale. If the payments under the agreement for sale are not brought up to date by the expiry of the redemption period, the petitioner will apply to the court for an order cancelling the agreement.

APPENDIX 15.1

Form B – Mortgage

LAND TITLE ACT
FORM B (Section 225)

MORTGAGE - PART 1 Province of British Columbia

LOCK

PAGE 1 OF 2 PAGES

Your electronic signature is a representation that you are a subscriber as defined by the Land Title Act, RSBC 1996 c.250, and that you have applied your electronic signature in accordance with Section 168.3, and a true copy, or a copy of that true copy, is in your possession.

1. APPLICATION: (Name, address, phone number of applicant, applicant's solicitor or agent)

Import Profile

Deduct LTSA Fees? Yes ☒2. PARCEL IDENTIFIER AND LEGAL DESCRIPTION OF LAND:
[PID] [legal description]

No PID NMBR

STC? YES ☐

Pick up STC?

Use 30 Parcel Schedule

Use 3 Parcel Schedule

3. BORROWER(S) (MORTGAGOR(S)): (including postal address(es) and postal code(s))

Use Schedule

BRITISH COLUMBIA
CANADA

Joint Tenants?

4. LENDER(S) (MORTGAGEE(S)): (including occupation(s), postal address(es) and postal code(s))

Use Schedule

Institution Profile

BRITISH COLUMBIA
CANADA

5. PAYMENT PROVISIONS:

(a) Principal Amount:	(b) Interest Rate:	(c) Interest Adjustment Date:	Y	M	D
(d) Interest Calculation Period:	(e) Payment Dates:	(f) First Payment Date:			
(g) Amount of each periodic payment:	(h) <i>Interest Act</i> (Canada) Statement. The equivalent rate of interest calculated half yearly not in advance is % per annum.	(i) Last Payment Date:			
(j) Assignment of Rents which the applicant wants registered ? YES <input type="checkbox"/> NO <input checked="" type="checkbox"/> If YES, page and paragraph number:	(k) Place of payment:	(l) Balance Due Date:			

APPENDIX 15.1, continued**Form B – Mortgage****MORTGAGE – PART 1**

PAGE 2 OF 2 PAGES

6. MORTGAGE contains floating charge on land ?

YES ☐ NO ☒

7. MORTGAGE secures a current or running account ?

YES ☐ NO ☒

8. INTEREST MORTGAGED:

Freehold ☒Other (specify) ☐

9. MORTGAGE TERMS:

Part 2 of this mortgage consists of (select one only):

(a) Prescribed Standard Mortgage Terms ☐(b) Filed Standard Mortgage Terms ☒(c) Express Mortgage Terms ☐

D F Number:

(annexed to this mortgage as Part 2)

A selection of (a) or (b) includes any additional or modified terms referred to in item 10 or in a schedule annexed to this mortgage.

10. ADDITIONAL OR MODIFIED TERMS:

Use Schedule

11. PRIOR ENCUMBRANCES PERMITTED BY LENDER:

Use Schedule

12. EXECUTION(S): This mortgage charges the Borrower's interest in the land mortgaged as security for payment of all money due and performance of all obligations in accordance with the mortgage terms referred to in item 9 and the Borrower(s) and every other signatory agree(s) to be bound by, and acknowledge(s) receipt of a true copy of, those terms.

Officer Signature(s)

Execution Date

Y M D

Borrower(s) Signature(s)

Y	M	D

OFFICER CERTIFICATION:

More Signatures

Your signature constitutes a representation that you are a solicitor, notary public or other person authorized by the *Evidence Act*, R.S.B.C. 1996, c.124, to take affidavits for use in British Columbia and certifies the matters set out in Part 5 of the *Land Title Act* as they pertain to the execution of this instrument.