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LENDERS WITH A FIRST MORTGAGE:

Be Careful When Adding Costs to the Principal Amount on Renewal

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Abstract

A first mortgagee cannot amend a mortgage in such a way that will prejudice the second mortgagee unless it obtains the second mortgagee's consent. It is for this reason that first mortgagees must draft a mortgage agreement that covers potential accommodation fees, legal fees, brokerage fees and tax arrears. This will ensure that second mortgagees are given proper notice of the potential for such fees having priority over their secured loan before they agree to provide said loan to the mortgagor. Without providing this requisite notice to mortgagees subsequent in priority, claims for these additional fees and expenses will not have priority over the second mortgagee's security interest. Therefore, it is a good idea to have a well written mortgage and commitment letter that contemplates the possibility of extra fees and expenses at the outset.

Full Article

In *Elle Mortgage Corporation v. Adalath*, the first mortgagee, Elle Mortgage Corporation ("Elle"), commenced an action to determine the distribution of funds following a power of sale action.

The borrower initially secured a mortgage with an institutional lender on an Ajax, Ontario property. The borrower subsequently secured a line of credit with another institutional lender as a second charge on the same property. A few years later the first mortgagee assigned its first mortgage to Elle.

The borrower defaulted on its mortgage with Elle. The borrower entered into a mortgage accommodation agreement with Elle in order to give the borrower additional time to either refinance or sell the property. In this agreement the borrower agreed to increase the principal amount under the first mortgage representing a brokerage fee, legal fees and to cover tax arrears. In addition, the interest amount was increased and the borrowers were charged a renewal fee of 5% of the remaining balance.



Lenders with a First Mortgage

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The borrower also defaulted on its second mortgage. The second mortgagee argued that the additional fees claimed by Elle were not set out in the original terms of the first mortgage, rather they were contained in the amending and renewal agreements entered into between Elle and the borrower, without notice to or consent of the second mortgagee. It follows that the additional fees rank behind the second mortgagee's security interest in the property. The court agreed that the second mortgagee had not been given notice of or consent to Elle's additional agreements with the borrower. The court said that secured lenders subsequent in priority to the first mortgagee are entitled to rely on the first mortgage agreement and cannot be prejudiced by unknown terms. It follows that first mortgagees are not permitted to make amendments to the mortgage agreement such that it would wipe out the interest of the subsequent mortgagee. To allow this would give no certainty as to the present or future value of security given to a potential lender.

Elle argued that the standard charge terms in the first mortgage made references to the possibility of additional fees and expenses. In response, the court stated that the references made in the standard charge terms were vague and unascertainable to lenders subsequent in priority and were of no effect.