



A Borrower's Guide to Foreclosure

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Introduction

Fewer than 3% of all Canadians are sufficiently wealthy to be able to pay cash for their new houses. They must borrow money to purchase the single largest asset of their lives. Since land can be readily pledged to guarantee the repayment of that loan, this security – the household mortgage – is a contractual and realty obligation with which most Canadians will be familiar at some point in their lives.

We have seen in the last few years how the rapid expansion of the North American residential real estate market was fueled largely by unrealistically cheap credit. This led to an unprecedented level of individual defaults on mortgages and ensuing foreclosures, a development which, on a broader scale, caused a global economic crisis.

The current unemployment rate in Canada, according to Statistics Canada, is about 8.75%. With more people becoming unemployed and under-employed in the last few years, they will have a harder time meeting their debt obligations. Mortgage defaults and legal remedies under mortgage documentation will increase in the years ahead.

Buying land and signing a mortgage does not invariably mean that one reads the documents and understands the rights conveyed to the lender in the event of

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default. While rates, principal amounts and amortization periods are negotiated, the mortgagee remedies are generally standard in all mortgages and not negotiable by the borrower. Lenders are very powerful and have many protections, in convoluted legal jargon, written into standard mortgage contracts, which borrowers usually sign without complete understanding.

Most borrowers (mortgagors, who pledge their land in return for their repayment promise) sign the legal documents on faith, so that they can move in to their new property. They do not expect to default on the mortgage payments. The legal details of the mortgage will be learned, if at all, when default occurs. At that time, the financial distress leaves the mortgagor little room to navigate a range of unattractive options.

In an ideal world, one would make all payments on time and avoid the mortgage enforcement process. But as we know, circumstances change and life does not always happen according to plan. This article describes the remedies available to the mortgage lender (mortgagee) against the mortgagor in default of the standard residential mortgage in

Canada. If one understands the fundamental options and the legal process around mortgage remedies, one might better prepare to deal with them.

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[To keep this terminology straight, it might help to remember that the mortgagor (the suffix “or” means “to give”) gives an interest, pledge or charge in his land to the mortgagee (the suffix “ee” means “to receive”) in return for the loan.]

Source of Legal Authority for Foreclosures

Under our Constitution, mortgages and foreclosures are mostly regulated provincially. Other than the federal *Interest Act* and the *Canada Housing Act*, which creates the Canada Mortgage and Housing Corporation, regulation is provincial. Accordingly, there will be differences in the law and practice across the country. Even within the province, a variety of legislation, case law and judicial practice governs foreclosure.

Recognizing that housing is a basic human necessity, legislatures have granted certain rights to favour the mortgagor, rights that provide procedural safeguards and slow the foreclosure process. No individual may be forced by a mortgagee to contract out of these statutory rights.

Some of the statutes regulating mortgages and foreclosures in Alberta are the *Law of Property Act*, *Judicature Act*, *Land Titles Act*, *Condominium Property Act*, *Builders' Lien Act*, *Interpretation Act*, *Mortgage Broker Regulations Act*, *Unconscionable Transactions Act*, and the *Rules of the Court*.

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The other main source of legal authority will be the mortgage contract. In this instrument, the mortgagor will have voluntarily pledged the land as security and granted the mortgagee special powers in the event of default. Recognizing the high stakes involved in one losing one's home and largest asset, the law requires the mortgagee to obtain approval for all remedial steps from a judge. The supervising court will usually exercise its discretion to demonstrate generosity to the personal mortgagor facing foreclosure proceedings.

Any Flexibility to Reschedule Payments?

The mortgagee is free to commence legal action the day after default, but rarely does so. Informal resolution may be in its best interests. Foreclosure is a long, expensive, discretionary process with many other steps before the final order for foreclosure is granted. The time immediately after default of payment is a crucial time for both the borrower and the lender to negotiate.

Mortgagors unable to make payments should plead their case to the mortgagee and ask to 'reset' the mortgage. In other words, they should attempt to negotiate more time to pay or a way to refinance the mortgage to make it more serviceable. Mortgages are a matter of private law so the two parties are in control. Whatever they work out as a new arrangement will govern, including a voluntary transfer of the land to the mortgagee (called a Quit Claim) in return for a short term lease. As a business matter, mortgagees will want to be convinced of tangible hope for payment by the mortgagor under a new realistic repayment plan. If not, it will be better off to move and realize upon the security of the land.

Sell the Property?

The mortgagor's equity in a property is the value in the land above what is owed to the mortgagee. If, for example, the current market value of the home is \$450,000, and the current amount owed on the mortgage is \$380,000, the mortgagor owns \$70,000 of equity in the land. It would be a shame for the mortgagor to lose this value through foreclosure.

In many provinces of Canada that follow the land titles system, by law the mortgagor (not the mortgagee) remains the registered owner of the land. The house is pledged as security only, and is not transferred to the mortgagee when the loan is made at closing. This means the mortgagor, who might be asset-rich but cash-poor, can try to sell the property on the open market and fetch the highest price possible for it. The whole mortgage and arrears can then be paid off, pleasing the mortgagee. The mortgagor pockets the \$70,000 equity, and can apply it toward the next home.

Alternatively if the mortgagee proceeds with a judicial sale to realize on its security, the mortgagor is not in control of the sale, the property is usually not presented in its marketable best, and sale timelines are short. This is referred to as a "forced sale," usually to a smaller market of frugal 'foreclosure' buyers. All these factors combine to produce a lower sale price, and when legal and selling costs are accounted for, there will be little in the way of equity left for the mortgagor.

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If there is negligible equity in the property, there will be likewise negligible economic incentive for the mortgagor to conduct a private sale.

Action on the Covenant to Pay

Every mortgage is a loan giving rise to debt obligations. The mortgagor promises to make each payment in accordance with the agreed repayment schedule. If regular payments are missed, the mortgagee may sue “on the covenant to pay” as promised. Usually a first default of one or two months of payments will lead to demand letters asking for the arrears to be paid immediately. A small claims judgment can be obtained in court but it must be enforced. If the borrower has no income or savings, this kind of unsecured judgment will have limited efficacy, especially as payments continue to be missed each month.

The strength of a mortgage is the security or charge on the land it provides, eventually the bank will seek to move against the land to optimize recovery of the loan.

Order for Possession

If renegotiation, mortgagor’s sale and action on the covenant all fail, and the arrears continue to accumulate by the month with little hope of redemption, and perhaps the condition of the property – if not the real estate market itself – obviously deteriorating, the mortgagee will have no practical alternative other than to escalate the legal remedies. These remedies are found in the mortgage contract.

The mortgage contract usually states that as long as the mortgage is in default, the mortgagee is entitled to physical possession of the property. The mortgagee may apply to the court for

possession, especially if it wants to sell the land, but banks frequently leave mortgagors in possession. Judges are sympathetic to families and are careful not to evict them from the property, especially during the winter and if they have equity in the land.

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Foreclosure

A complex legal procedure, supervised by the Court, follows one’s default on a mortgage. It operates to transfer the mortgaged property from the borrower to the lender and erase the interests on title of those who registered them after this mortgage was registered. Any equity that one had in the land is extinguished and any debt outstanding on the mortgage is permanently settled. After foreclosure the mortgagee is not answerable to a mortgagor’s claim for any lost equity.

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Notification

The mortgagee formally notifies the mortgagor of the default by letter setting out the amount outstanding and the deadline extended to pay, usually measured in weeks. Without payment, the mortgagee will file a Statement of Claim to execute on the security.

Defences

The language of the mortgage contract allows for few meaningful legal defences once a mortgage payment has been missed. One might argue that one did not know what one was signing, or that there was misrepresentation or fraud, or that there is some technical defect in the mortgage (such as that it was not sufficiently in writing) but these defences are rarely successful. Some mortgagors file a Statement of Defence on the basis that they were wronged in the mortgage process, but this rarely succeeds. There may also be a disagreement between the parties on the correct amount outstanding on the mortgage, or the applicable interest rate, or appraisal and foreclosure costs, but these are not substantive defences and they can be quickly resolved by the judge.

That one or more payments have been missed is not difficult for the mortgagee to prove. The loss of one's job, health or other personal affliction will not comprise an effective legal defence for the default. Foreclosures are mainly procedural. There is no need for a regular trial since proof of the obligation and ensuing default are easy, and legally-recognized defences are difficult to factually assert. Many mortgagors do not even defend against the foreclosure, but merely file a Demand of Notice which asks the mortgagee to keep them informed of the process and permit them to intervene and make submissions as it unfolds.

Equity of Redemption

From default until final order of foreclosure, the mortgagor enjoys the right to redeem the mortgage. That means one can pay all arrears, legal costs and interest to get the mortgage back into good standing and terminate the foreclosure proceedings.

Foreclosure proceedings on a residential property can take up to a year, depending on the condition of the property, whether the house is being offered for sale, personal mortgagor circumstances, amount of equity and the prevailing real estate market. This may afford the mortgagor considerable time to obtain the redemption funds, including through re-financing from other sources.

An "Order Nisi" (specific performance) by the court stipulates the amount owed to the mortgagee, and the time for redemption. The redemption period will depend upon several factors, most notably the personal circumstances and pleas of the mortgagor, the amount of indebtedness on the mortgage, and the amount of equity in the land. The more equity held by the mortgagor, the less likely one will persist in the default of payment and, equally, the less risk for the mortgagee. A standard redemption period is about six months. However, actual redemption can occur right up until the moment the property is transferred, although redemption is rare at that

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point. The legal definition for the word “foreclosure” according to the *Law of Property Act* is the point at which the mortgagor is “deprived of his equitable right to redeem.”

Sale

When the redemption period in the Order Nisi expires, the court will order the property to be foreclosed (legally transferred to the mortgagee) or sold to a third party. Various methods can be used for the “judicial sale,” such as by tender, by advertisement, or by a realtor, at the discretion of the court and preference of the mortgagee.

Tenders may be invited through the Legal Notices section of the newspaper. Interested bidders can tour the property, review the Certificate of Title and submit a sealed, written offer with 10% of the bid rendered with the offer. The offers are collected and reviewed after the tender period closes. The highest one may be recommended by the mortgagee for acceptance by the judge. The court will accept a tender approaching the market value of the property to extinguish the debt owed by the mortgagor. It will issue an Order for Sale and the successful bidder must close within a few weeks.

If the property is not sold, it could be re-advertised or transferred to the mortgagee. A Final Order of Foreclosure will transfer ownership in the property, delete any equity and terminate the right of redemption forever.

Deficiency

If the property is sold for an amount that covers the mortgage indebtedness, accrued interest and legal costs, the sale proceeds will be distributed to the mortgagee and other creditors, and any surplus paid to the mortgagor. Much more common, by far, is that the sale does not net enough money to even pay off the mortgage debt. Can the mortgagee pursue the former mortgagor for the deficiency?

Generally, the final order of foreclosure or sale extinguishes the entire debt obligation, even if the mortgagee obtains only part of the loan. By legislation, once the mortgagee has exercised its right to execute on the land secured, it cannot also turn to the debtor for payment of any deficiency. There are a few exceptions to this rule, such as where the original mortgage was taken by a Crown corporation (such as CMHC or ATB Financial) or given by a corporate mortgagor. In those cases, everyone who was ever on title to the land may be subject to contribute to the deficiency.

Conclusion

Foreclosure is only the final step in a long legal process. This lengthy, technical court-supervised process ensures the protection of the individual mortgagor from unjustly losing his home and largest asset.

Ultimately, foreclosure is a human process, driven primarily by mortgagee economics. Yet human considerations will play out by way of decisions by both the mortgagee’s agents and the judges. Individuals in their residential property and corporate mortgagors in their commercial property are each treated differently by the

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law in foreclosure proceedings. This reflects compassion toward individual debtors with residential property that does not exist for corporations.

Foreclosure plunges mortgagors into an uncertain, wrenching, time-consuming ordeal, over which they have little control. They face increased costs from interest and legal fees, which the mortgage states the mortgagor must repay the mortgagee on a full indemnity basis. The long term loss of credit worthiness from a foreclosure may mean the mortgagor may never be eligible for another conventional loan at an attractive rate. Foreclosures, much like bankruptcies, are not a pleasant area of the law, and should be subsequently avoided whenever possible. Mortgagors in financial distress should take default and the threat of foreclosure action seriously. They should always strive to work out a practical solution with the mortgagee.

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