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Real Estate

Construction financing vs. writs of seizure and sale: who trumps who?

By **Harjot Atwal**

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(July 29, 2020, 2:37 PM EDT) -- In an industry particularly prone to financial failures, construction lenders and writ/execution creditors often find themselves at odds when seeking repayment of debts. This is partially because, in the construction context, mortgage funding works differently. Instead of advancing all funds on closing as is often done post-construction, a certain percentage of funds (also known as "draws") are advanced as different stages of construction and development are completed.

For example, a first optional draw of 15 per cent of the total mortgage amount may be available when excavation and the building's foundation are complete, but a second 25 per cent draw may be required to be taken when a roof is placed on the building and it becomes airtight.

Unfortunately for execution creditors, this state of affairs makes it far more difficult to collect on any court judgments they may obtain against the legal or beneficial owners of the property being constructed. The concern is that, even if execution creditors file a writ of seizure and sale (writ) to try to obtain the property's net sale proceeds in order to satisfy the judgment amount, there may be no funds available upon the sale due to the priority nonetheless given not only to prior draws but also to subsequent mortgage advances after the writ was filed. As execution creditors already rank lower than contractors with construction liens for the materials and services they supply, this further diminishes available debt repayment funds.

Say, for example, a writ is filed a few months after obtaining a judgment for $100,000 plus interest and costs in late 2017, but the property is subject to two construction financing charges registered in 2016 for which further advances were to be made in 2018 or thereafter. The question then becomes: who trumps who? Construction lenders or execution creditors? In what order are the writ amount and subsequent mortgage advances prioritized with respect to accessing sale proceeds in case there are not enough funds to make all parties whole in the end?

These were the facts and (some of) the questions before the Ontario Court of Appeal in *1842752 Ontario Inc. v. Fortress Wismer 3-2011 Ltd*. 2020 ONCA 250. The appellant had obtained the aforementioned $100,000 judgment against Fortress Wismer 3-2011 Ltd., filed a writ, and sought to enforce it against lands for which Fortress Wismer was the 35 per cent beneficial owner. After filing the writ in the jurisdiction where the lands are located, the appellant gave the first construction lender (Firm Capital) "actual notice" of its writ, presumably by mailing a letter enclosing a copy of it to Firm Capital. The purpose of this actual notice was to try to make any subsequent mortgage advances subordinate to the $100,000 writ through the operation of s. 93(4) of the *Land Titles Act* as second mortgagees are capable of doing.

Firm Capital disagreed, and insisted that any further draws it gave to the legal property owner (a trustee) would have priority over the writ, regardless of its actual notice of the writ. It argued that s. 93(4) neither mentions nor applies to execution creditors. Since Fortress Wismer, as beneficial but not legal owner, has no right to interrupt ongoing construction financing, the appellant execution creditor could not do so either.

Instead, the execution creditor could only step into the shoes of and has no higher rights than the debtor — Fortress Wismer. Even if Fortress Wismer had also been the 100 per cent legal owner, this would still not grant the execution creditor any priority over the previously registered mortgagee due to the wording of s. 93(4), and the execution creditor would likely only be able to use the writ to sell the land and thereby interrupt future construction financing not yet advanced.

Until now, various lawyers have commented that the law here was not entirely clear. Indeed, after filing a writ in the appropriate jurisdiction, execution creditors were advised to send a letter enclosing the writ by registered mail to all mortgagees registered on title to the construction property. Similarly, before giving each mortgage draw, construction lenders were instructed that a writ search needed to be conducted to become cognizant of all judgments, and that they should not simply rely on arguments related to lack of actual notice.

In cases where mortgage security was taken over a portfolio of properties in different jurisdictions, execution creditors were warned that filings had to be completed in each jurisdiction and construction lenders accordingly had to do multiple jurisdictional writ searches.

However, given the Court of Appeal's decision in *Fortress Wismer*, such lawyers' instructions seem partially inapplicable now. While multi-jurisdictional writ searches (particularly by lenders trying to determine the borrower's solvency and likelihood of paying back debts prior to making an advance) and writ filings should still likely be done, the court's conclusions demonstrate that giving actual notice to a construction lender with a mortgage registered prior to a writ filing will not matter in the long run.

Regardless, it will not lead to the execution creditor gaining priority over subsequent mortgage advances made under that previously registered mortgage. This result is somewhat surprising given the seminal decision on actual notice of the Supreme Court of Canada in *United Trust v. Dominion Stores et al*. [1977] 2 S.C.R. 915. In that case, the Supreme Court held that several provisions of the Act did not abolish the doctrine of actual notice, and that a purchaser for value with actual knowledge of an unregistered lease interest took title to the purchased property subject to it.

Since the writ's purpose is to seize and sell land, and it is also not registered on title, one might be tempted to think that previously registered mortgagees with knowledge of a writ may also make their subsequent mortgage advances subject to the writ's priority. Nevertheless, the Ontario Court of Appeal decided differently, stating there is a long line of cases that confirm a writ does not confer any interest in land.

The appellate court further held that a plain reading of s. 93(4) of the Act indicates it does not apply to execution creditors, so they cannot take advantage of it to gain priority. The court went on to discuss how the *Execution Act* does not grant any substantive rights to execution creditors, and how the *Creditor's Relief Act*, 2010 only grants priority to such creditors when mortgages are registered after a writ filing.

Where does this leave the appellant execution creditor trying to collect on its unpaid judgment? Not only could it not bind the legal owner using its writ against the 35 per cent beneficial owner to force a partition and sale of the lands, but it also became responsible for $16,300 of the respondent's legal costs for the appeal in addition to its own legal fees. Given these costs and the remaining uncertainty of whether the $100,000 judgment can eventually be collected, and especially given their decided lack of priority over subsequent construction mortgage draws and advances, it appears execution creditors should think twice before going down similar litigious roads for debt repayment in such circumstances.

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