

I'm a Lender! How do I get my 3-month Interest Penalty on a Borrower Default?

Business Law | Corporate & Commercial | Lending | Mortgage | Ontario Mortgages Act | Real Estate

26 April 2023

Under Section 17 of the *Mortgages Act*, R.S.O. 1990, despite any pre-existing mortgage agreement, where a borrower is in default for payment of principal money secured by a mortgage, the borrower in default is entitled to three months' notice to arrange for repayment of principal or payment of the principal amount owing with an additional three months' interest.

Subject to the wording in the original mortgage commitment/agreement, lenders will often charge a three month interest penalty if they have to enforce the mortgage via power of sale proceedings or if the borrower neglected to renew the mortgage once the term had expired and they failed to repay the mortgage loan at that time.

So long as lender penalties are clear and reasonable, the courts have often ruled in favour of lenders regarding their right to charge penalties when a borrower defaults on its mortgage loan obligations.

Guller v. Income Trust Co. is the legal authority allowing a lender to require payment of three months' interest as a bonus upon a borrower repayment default occurring at maturity of the mortgage. The court holds the view that a borrower should not be able to avoid the covenant to pay three months interest by defaulting and forcing the lender to enforce the charge.

Courts have routinely upheld that it would be inequitable for the borrower to benefit from a failure to remedy its default by forcing the lender into a power of sale proceeding. A lender is therefore entitled to claim the three months of interest as part of the amount required to redeem the mortgage after a notice of sale is issued.

However, there are cases where the courts have ruled in favour of borrowers. A student housing development that went into default had a receiver appointed by the lender. The property was eventually sold through the receiver and the mortgage repaid and discharged along with a three months' interest penalty. At the Court of Appeal, in *58 Cardill Inc. v. Rathcliffe Holdings Limited*, the lender argued that the receiver was an agent of the borrower and the three months' interest penalty was justified. The Court of Appeal rejected this argument. The role of the receiver was not to realize maximum recovery on the property for the benefit of and as agents of the borrower. As such, the lender was not entitled to claim this penalty on a forced sale even where an appointed receiver acted.

Lenders should therefore be cautious in including penalty provisions in their loan documents and, in particular, claiming the extra three months' interest.

For more information please contact: **Zev Zlotnick** at **416.865.6601** or **zzlotnick@grllp.com**

(This blog is provided for educational purposes only, and does not necessarily reflect the views of Gardiner Roberts LLP).

Author



Zev Zlotnick

Partner

416.865.6601

zzlotnick@grllp.com



Bay Adelaide Centre — East Tower
22 Adelaide Street West, Suite 3600
Toronto, ON M5H 4E3

Phone: 416.865.6600
Fax: 416.865.6636
contactGR@grllp.com