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Commercial Real Estate Lenders and Construction Liens

By Zev Zlotnick

Commercial real estate lenders operating in Ontario must be vigilant about construction liens due to the significant legal and financial implications these liens can impose. The construction lien regime in Ontario is governed by the *Construction Act*, R.S.O. 1990, c. C.30 (formerly known as the Construction Lien Act), which establishes a framework that protects the rights of contractors, subcontractors, and suppliers by ensuring they are paid for their work and materials. This framework has direct consequences for lenders in several key ways.

Lender Risks

1. Priority of Liens: Under the Construction Act, a construction lien can take priority over other registered interests, including a lender's mortgage. If a lien is registered against a property, it can supersede the lender's security interest, which jeopardizes the lender's position in case of default or foreclosure. This priority is rooted in the Act's mandate to protect those who have contributed to the improvement of the property, emphasizing the importance of promptly addressing and resolving any liens.

2. Holdback Requirements: The Construction Act requires property owners, including those with a lender's interest, to retain a statutory holdback of 10% of the contract price. This holdback serves as a fund to satisfy any lien claims that may arise. Lenders need to ensure that these holdbacks are properly maintained to avoid liability and ensure compliance with statutory requirements.

3. Liability for Unpaid Liens: If a borrower defaults on loan payments and there are outstanding construction liens, the lender may find itself in a position where the property is encumbered by these liens. The lender might need to pay off the liens to clear the title, which can be a substantial and unexpected financial burden.

Practical Implications for Lenders

1. Due Diligence: Before advancing funds, lenders should conduct thorough due diligence to identify any potential or existing liens. This includes reviewing title searches and lien filings to assess any risks associated with the property.

2. Monitoring and Compliance: Throughout the construction process, lenders should implement robust monitoring mechanisms to ensure compliance with holdback provisions and the timely payment of contractors and suppliers. Regular inspections and progress reports can help in identifying and mitigating lien-related risks.

3. Legal Recourse and Enforcement: Understanding the provisions for vacating or discharging liens under the Construction Act is crucial. Lenders should be prepared to take legal action to resolve lien disputes, which may involve posting security or making payments into court to discharge liens and protect their security interests.

For commercial real estate lenders in Ontario, construction liens represent a significant legal and financial risk. By understanding the statutory framework of the Construction Act and implementing rigorous due diligence and monitoring practices, lenders can mitigate these risks and protect their security interests. Proactive management of lien-related issues is essential to ensuring the smooth operation and profitability of commercial real estate lending activities in Ontario.

For any related questions, please contact the writer. To see my previous 1-Minute Reads for Commercial Mortgage Lenders, please visit the Blog portion of my profile at https://www.grllp.com/profile/zevzlotnick

Contact Us

If you are in need of legal advice, please do not hesitate to contact Zev Zlotnick, at 416.865.6601 or zzlotnick@grllp.com.

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Zev Zlotnick
Partner
416.865.6601
zzlotnick@grllp.com