

Mortgage syndicate required to repay funds to investor due to breach of subscription agreement

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Mortgage syndicates may offer individual investors the opportunity to realize high rates of return by participating in real estate developments and other projects. However, notwithstanding that the funds invested may be secured by way of a mortgage, the pooling of money with other investors and the role of the intermediary agents and trustees in controlling the funds creates risks that are not usually associated with a conventional mortgage. Participation in a mortgage syndicate usually involves a “subscription agreement” between the individual investor and the party to whom they pay their share of the funds for the project. Such agreements have received relatively little consideration by the courts to date.

In *Khwaja v. Jinnah*, 2021 ONSC 4614 (CanLII), the plaintiff was a homemaker who had invested \$100,000 in a mortgage syndicate. In November 2007, she and her late husband were encouraged by an individual they met through a mutual friend to participate in an investment opportunity for a development project in Richmond Hill, Ontario, for the construction of 118 residential homes by a builder/developer known as Silver Streams Homes.

A corporation known as “53 Puccini” was incorporated to provide a vehicle for lenders to the project through a mortgage syndicate to be held in trust by 53 Puccini. The mortgage would be registered against title to the land registered to a numbered company, 214 Ontario. During the term of the loan, investors would receive monthly interest payments. Investors were to be repaid in full from the sale of the proceeds of completed homes.

On December 3, 2007, the plaintiff paid \$100,000 to 53 Puccini and executed a Subscription and Power of Attorney Agreement. She later admitted that she did not read the Subscription Agreement before she signed it, but she understood that it was a legal document whose terms had legal significance.

The Subscription Agreement provided that the mortgage syndication funds would be only used in connection with a second mortgage on the project lands in Richmond Hill. It conferred broad power and authority on 53 Puccini to act as attorney and agent, including the power to discharge mortgages and execute other instruments necessary to facilitate the development of the project.

Importantly, by the terms of the Subscription Agreement, 53 Puccini was acting as the agent or trustee for the individual investors who collectively formed the mortgage syndication. When the funds were then loaned by 53 Puccini, 53 Puccini was the mortgagee (lender) and 214 Ontario was the mortgagor (borrower).

In January 2008, the 53 Puccini mortgage on the lands in Richmond Hill was discharged from title and transferred to a mortgage held in the name of Icorp Global, which was registered on another property in Whitby, Ontario.

While an Acknowledgement, Direction and Release was prepared whereby investors in the Richmond Hill project would transfer their interest in the mortgage to the replacement mortgage on the Whitby property, the undisputed evidence was that the plaintiff never signed this document.

In mid-2009, the plaintiff met with Mr. Jinnah to find out when she would get a return on the investment since some of the homes on the Richmond Hill property had sold. The Subscription Agreement also contemplated that the Mortgage on the Project land would mature on 1 April 2009. At that time, she learned for the first time that the mortgage on the Richmond Hill property was transferred to the Whitby property.

On 16 February 2010, the replacement mortgage held by Icorp Global on the Whitby project was also discharged.

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In 2013, Silver Streams Homes began to experience significant financial challenges. In December of 2013, Silver Streams and various related companies that owned the lands in the Richmond Hill project, including 214 Ontario, were granted court protection under the *Companies Creditors Arrangement Act (CCAA)*.

The plaintiff received thirteen sporadic interest payments on her investment between April 2009 to January 2011, totalling \$18,750. In 2013, the interest payments stopped. She sued 53 Puccini for the return of her principal. But 53 Puccini was no longer holding the plaintiff's funds in trust and was not an active company.

In 2021, the Ontario Superior Court of Justice heard competing summary judgment motions brought by the plaintiff and 53 Puccini.

The plaintiff argued that 53 Puccini was liable as a borrower of her funds. However, the Subscription Agreement did not contain any covenant by which 53 Puccini either agreed to pay back the plaintiff's funds or guaranteed repayment. While 53 Puccini agreed to act as the attorney or agent for the investors in the project, the court was not prepared to read into the Subscription Agreement terms that created a lender-borrower relationship between the plaintiff and 53 Puccini.

Based on the Subscription Agreement, the lender in the project was 53 Puccini and the borrower was 214 Ontario. 53 Puccini wore a "double hat" as the agent or trustee for the individual investors, but the Subscription Agreement did not impose a positive obligation on the mortgage syndicate to repay a loan. In an earlier decision, the court in *Orwinski v. Hi-Rise Capital*, 2019 ONSC 3975 had reached a similar conclusion and ruled that a mortgage syndication agreement does not establish a lender-borrower relationship or an unqualified right to a return of capital.

What 53 Puccini's obligation was, however, was to hold and invest the funds received from investors only in connection with the project for the development in Richmond Hill.

In this regard, the court agreed with the plaintiff that the discharge of the mortgage on the Richmond Hill lands and the transfer to another company for a mortgage on lands in Whitby was a breach of contract since the plaintiff's consent and agreement had not been obtained.

The court found that the Subscription Agreement did not confer a broad authority on 53 Puccini to discharge the Richmond Hill mortgage and transfer it to another property as it saw fit. It was incumbent on 53 Puccini, as agent and trustee for the plaintiff, to obtain the plaintiff's authorization and consent before doing so.

In the court's view, to interpret the Subscription Agreement as giving unrestricted authority for 53 Puccini to discharge and transfer mortgages as it saw fit makes little commercial sense. New investors would not be able to appreciate the risks at the time of contract formation. While investors were advised that there were significant risks with the investment and project, they understood those risks were limited to the risks inherent in having a second mortgage secured on the lands in Richmond Hill. The transfer of the mortgage, without the consent of the investor, created new risks that the investors were entitled to understand as a condition of having 53 Puccini continue to serve as their agent. This opportunity was not afforded to the plaintiff.

In the result, the court found that 53 Puccini breached its contract with the plaintiff and was liable to return the principal advanced, less the interest payments that had been made.

The decision reflects the risks inherent with investing in a mortgage syndicate, which is subject not only to the construction-related issues for a development, but also to the decisions of the individual agents and trustees who control the funds. At the same time, the decision shows that mortgage syndicate administrators and trustees must ensure that they comply with the terms of the applicable agreements with the individual investors. A PDF version is available to download [here](#).

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