

Why Commercial Real Estate Lenders in Ontario Should Avoid Being Co-Defendants in Construction Lien Matters

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In Ontario, commercial real estate lenders need to be cautious of their involvement in borrower construction lien matters, especially when it comes to being named as co-defendants. In a lien claim matter, the lien claimant will often include the mortgage lender as a co-defendant notwithstanding that the lender has no involvement or connection to the lien claim. If a lender is included as a party in a lien action, it complicates their ability to enforce a power of sale on the underlying property. Under the *Construction Act* (Ontario), liens take precedence over the mortgage debt if registered before the lender enforces power of sale, impacting both timelines and recoveries in the event of a borrower default. According to E-Reg Bulletin Guidelines, a lender's right to power of sale does not automatically clear any liens registered against the property. If a lender is named in a construction lien dispute, this lien can become an encumbrance that will persist through a power of sale, potentially deterring buyers or complicating the transaction.

When a construction lien is filed against a property, all parties with an interest, including lenders, can be named as defendants in legal proceedings. For a lender aiming to recover the outstanding loan through a power of sale, being named as a co-defendant poses unique challenges. If the property is sold under power of sale while the lien is active, the lien won't automatically "fall off" or be removed upon closing. This can result in a buyer taking on a property still encumbered by the lien, an unattractive prospect that could deter potential purchasers or diminish the property's market value.

E-Reg Bulletin Guidelines underscore that lenders cannot unilaterally discharge a lien upon exercising power of sale; liens must be removed through a settlement or court order. Key Ontario cases, such as *Structform International Ltd. v. Baffo & Sons Construction Ltd.* (1983), have confirmed that a lender who appears as a party to the lien action may face greater difficulty in exercising rights under the mortgage due to the outstanding lien obligations. The courts have consistently maintained that, if included in lien proceedings, lenders have limited options in unencumbering the property without directly addressing the lien.

Lenders are advised to structure their loan agreements with clauses that allow them to ensure timely payments to contractors, avoiding lien registrations. In case of defaults, lenders should take swift steps to address any liens before initiating power of sale, avoiding involvement in construction lien actions whenever possible. To the extent they are named in lien proceedings, lenders should proactively seek to be removed as a co-defendant in such lien matters. It prevents delays and complications should a power of sale process arise, thereby allowing them to secure their financial position more effectively. By taking these preventive measures, if a power of sale scenario is required, lenders can preserve the marketability of the asset and expedite the recovery of their investment.

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://grllp.com/zzlotnick#media-insights>. A PDF version is available for download [here](#).

For more information please contact: **Zev Zlotnick**

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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