Caution to Lenders: How to Recover Costs Incurred to Enforce a Mortgage

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Introduction

A mortgage is a well-known type of security pursuant to which a lender, such as a financial institution, or a private corporation or individual, lends money to the owner of real property in return for which the lender acquires rights and remedies over the real property which can be enforced if the borrower fails to comply with its obligations.

When a mortgage loan goes into default, a lender often expends a significant amount of time and effort, in addition to incurring out-of-pocket costs, managing the loan recovery. Counsel to mortgage lenders, both in drafting mortgages and litigating against borrowers, must therefore advise their clients what the courts may require from the lender, after a default under the mortgage, to enforce the "repayment" provisions in the mortgage and what fees, costs and charges the lender can recover.

The Legal Test & Evidence Required

When considering the "repayment" provisions in the mortgage, lenders who take mortgages on real property as security should be mindful of section 8 of the *Interest Act* (the "**Act**") and the relevant case law. Intended to protect property owners against abusive lending practices, section 8 of the Act prohibits a fine, penalty or interest rate that escalates after default if the arrears are secured by a mortgage on real property, be it commercial or residential.

The legal test to determine whether fees, costs and charges offend section 8 of the Act and when in a mortgage they are recoverable was set out by the Ontario Court of Appeal in the case of *P.A.R.C.E.L v Acquaviva* ("***P.A.R.C.E.L***")[1]. The court held that for lenders to recover fees, costs and charges in the event of a borrower's default, the fees, costs and charges must reflect the real costs legitimately incurred by the lender. Moreover, in the absence of evidence to prove the incurred fees/charges, the court would then consider them to be a penalty or fine that escalated the interest rate agreed upon, therefore violating section 8.[2]

The common law recognizes that for good business reasons such costs can be estimated in advance and fixed in a contract.[3] The decision in *1539339 Ontario Inc. v First Source Financial Management Inc.*[4] ("***First Source***") confirmed the concept of a "reasonable pre-estimate of damages" and stated that if the fees and charges in the mortgage agreement were described as a "reasonable pre-estimate of damages" ***and*** were incurred by the lender, they would be collectable.[5] In *First*

Source, the Ontario Superior Court of Justice ruled that the management cost, holding over fee and other small charges were contractually described as reasonable pre-estimates of damages, not as penalties, and were, therefore, recoverable.

However, in subsequent cases[6], the court stated that as a matter of contract, if the mortgage agreement allows a fee to be charged there should be evidence of the actual cost incurred in order for the fee to be collected.[7]

In *BMMB Investments Ltd. v. Naimian[8]*, Justice Myers assessed the evidence (or lack thereof) filed in support of the fees, costs and penalties claimed. The lender claimed reimbursement for a number of disbursements that were allegedly incurred in enforcing the mortgage, including "property maintenance and management" fees, two appraisals, a corporate search, PPSA renewal, and HST on fees. However, none of the alleged disbursements were supported by invoices filed by the lender and there was no basis to assess whether the costs were incurred in the amounts claimed, let alone whether the alleged expenditures were reasonable.[9]

In the recent 2021 case of *We Care Funding Limited Partnership v. LDI Lakeside Developments Inc. et al.[10]*, the court stated that while a mortgagee is generally entitled to be indemnified for the costs that are incurred to respond to a default by a mortgagor, the costs claimed must be reasonable and properly incurred. There must be some basis in the evidence to determine that costs were incurred at the amounts claimed. Affirming the *P.A.R.C.E.L* test, the court held that, without evidence of the actual administrative costs incurred, the costs would constitute an increase in the interest rate applicable to monies in default, in excess of the interest rate payable upon moneys not in default, contrary to section 8 of the Act.

Conclusion

First Source makes clear that the "repayment clause" in the mortgage agreement should describe the fees and charges as a "reasonable pre-estimate of damages" to ensure lenders safeguard their ability to recover all of the fees, costs and charges incurred to enforce the debt a result of default. However, based on the recent case law, mortgage lenders should keep in mind that the fees and charges must be reasonable, should be contractually described as "reasonable pre-estimate of damages", must actually be incurred by the mortgage lender and must be supported by evidence in order to be collected from the borrower.

[1] *P.A.R.C.E.L v Acquaviva* 2015 ONCA 331.

[2] *P.A.R.C.E.L* at para 96.

[3] *BMMB Investments Ltd. v. Naimian*, [2020] O.J. No. 5634 at para 36.

[4] *1539339 Ontario Inc. v First Source Financial Management Inc.*, 2020 ONSC 5082.

[5] *1539339 Ontario Inc.* at para 47.

[6] *BMMB Investments Ltd.* and *We Care Funding Limited Partnership v. LDI Lakeside Developments Inc. et al.* 2021 ONSC 7466.

[7] *BMMB Investments Ltd.* at para 29.

[8] *BMMB Investments Ltd.*

[9] *BMMB Investments Ltd.* at para 26.

[10] *We Care Funding Limited Partnership v. LDI Lakeside Developments Inc. et al.* 2021 ONSC 7466.

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