

New Regulation Promises to Boost Lender Confidence When Borrowers Ask for Long-Term Mortgages

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With interest rates hovering around all-time lows, the desire of commercial borrowers to lock-in long-term mortgages has, arguably, never been greater. A new federal regulation which has just taken effect should give certainty to long-term lenders regarding loans to entities that are not corporations or individuals.

The new regulation, which revises Section 10 of the federal *Interest Act* and took effect Jan. 1, 2012, aims to ensure that businesses will have access to long-term mortgages. The impetus for the new regulation was the concern that lenders had over the years about uncertainties and potentially negative business impacts related to long-term mortgages that borrowers had been permitted by law to pay down early.

Ultimately, the revised Section 10 should bring greater stability, predictability and uniformity to an area of law in which the rules had become outdated.

A Brief History of Section 10 of the Interest Act

Section 10 of the *Interest Act* was enacted in the late 1800s. Its purpose was to provide relief to farmers who were being locked into high-interest, long-term mortgages with hefty prepayment penalties. The legislative remedy, then, was to give borrowers the right to prepay the principal of their mortgage with interest, together with a further three months interest, at any time after five years. The law did not bode well for lenders, who naturally became reluctant to provide mortgages with a term greater than five years. This, in turn, created difficulty for corporations, in particular railway companies, who were trying to obtain long-term loans secured by mortgages of real property. So, a decade later, a new law was passed [Subsection 10(2) of the *Interest Act*] which stated that the prepayment rights afforded by Subsection 10(1) did not apply to corporations.

Fast-forward nearly 100 years -- after it had become common practice for owners to structure commercial real estate acquisitions using limited partnerships, trusts and other business entities -- and the problems associated with the application of Subsection 10(1) resurfaced. For example, since partnerships and real estate investment trusts (REITs) cannot hold title to real property in their own name, they do so by using a nominee corporation. There was a question, then, of whether non-corporate entities such as limited partnerships and trusts, as beneficial owners, were entitled to the prepayment rights under Subsection 10(1).

The answer to this question was decided in *Litowitz v. Standard Life Assurance Co.*(1996), where the Ontario Court of Appeal held that the mortgagor, who in this case was a nominee corporation, did not have the prepayment right under subsection 10(1), even though the beneficial owner was a partnership. Moreover, to further complicate matters, in Quebec, there is no distinction between legal and beneficial ownership. So *Litowitz*, if tried in Quebec, may have received a different judicial result. With this in mind, it became evident that Section 10 was outdated and that there was a need for consistency in this area of the law across all Canadian jurisdictions.

What Exactly Has Changed?

As of last January 1, there is a longer list of prescribed entities that are not permitted under Subsection 10(1) to pay down mortgages early. Now, in addition to joint stock companies, corporations, and debentures issued by corporations, the following are added to the list set out in Sub-section 10(2):

- i) Partnerships,
- ii) Trusts settled for business or commercial purposes,
- iii) Unlimited liability corporations as defined in the *Business Corporations Act*, R.S.A. 2000, c. B-9,
- iv) Unlimited liability companies as defined in the *Business Corporations Act*, S.B.C. 2002, c. 57, and
- v) Unlimited companies as defined in the *Companies Act*, R.S.N.S. 1989, c. 81.

With respect to trusts, these are often used by individuals, so one must be particularly mindful of the objects and purposes of a trust when creating and using one as a borrower.

Implications

As lenders will now have greater certainty when granting long-term financing secured by a mortgage, borrowers likely will have more options available to them when seeking such loans. Legal practitioners will benefit, too, in that they should have increased certainty when giving an enforceability opinion to a lender.

Outstanding Jurisdictional Uncertainty

With the enactment of the new regulation, there remains some jurisdictional uncertainty in the laws. For example, in Ontario, the *Mortgages Act* still contains provisions that mirror the old Section 10 of the *Interest Act*. It is anticipated that this discrepancy will be resolved through further legislative reform. Until then, this should not cause great concern to those involved in commercial mortgage transactions, as they continue to have *Litowitz* and, of course, the new regulation to rely upon.