

Secured Real Estate Financing: Mortgage Amendments and Priority Disputes

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When a commercial loan secured by real estate is made by a lender, it is common practice for the borrower to grant the lender a mortgage that is registered on title to the property. If key terms of that loan are subsequently amended – for example, if the interest rate is increased – then typically the lender and borrower will enter into a loan amending agreement and a mortgage amending agreement, and the latter will be registered on title.

Sometimes, for various reasons, a borrower will get a second loan from another lender, who will register a second mortgage on title. Absent a priority agreement or postponement registered on title to the contrary, this second mortgage will rank behind the first mortgage. This means the first mortgage lender is entitled to get repaid before the second mortgage lender.

But what happens when both a first mortgage and second mortgage are registered on title and the first mortgage is subsequently amended? Do the amended terms of the first mortgage also have priority over the second mortgage?

Commercial lenders should be aware that in a recent Ontario case, [2495940 Ontario Inc. v. 263346 Ontario Inc., 2020 ONSC 7937](#), the court appears to have overturned longstanding case law in determining that the amended interest rate of the first mortgage had priority over the second mortgage. The court was persuaded by certain standard charge terms contained in the first mortgage, which said the following:

“...the Charge may be renewed by an agreement in writing at maturity for any term with or without an increased rate of interest notwithstanding that there may be subsequent encumbrances. It shall not be necessary to deliver for registration any such agreement in order to retain priority for the Charge so altered over any instrument delivered for registration subsequent to the Charge.”

Although the second mortgagee had no actual notice of the interest rate increase, the court said that the above terms were incorporated by reference into the first mortgage and as such the second mortgagee was deemed to have notice of the fact that the interest rate could be increased on renewal and that such increase would have priority without the need to register an amending agreement on title to the property.

We anticipate that a lot of commercial lenders will be concerned with this court decision as it may lead to uncertainty and commercially challenging scenarios where key first mortgage terms like interest or maturity can be changed in any way at any time so long as the mortgage contains a similar provision as the one at issue in this case, regardless of whether such change is registered on title and without proper consideration of the rights of subsequent encumbrancers.

Given this case, any second mortgagee would be well advised, before making its second mortgage loan, to review the first mortgage and, if it contains language similar to the language that existed in this case, the second mortgagee should insist on a priority agreement with the first mortgagee, to clarify that the first mortgagee cannot increase the interest rate under its loan and get priority over the second mortgagee with respect to that increased interest rate, unless the second mortgagee consents.

We understand the decision in *2495940 Ontario Inc. v. 263346 Ontario Inc.* is being appealed. Until then subsequent mortgagees should proceed with caution and consider entering into a priority agreement with the first mortgage lender to provide clarity as to how mortgage terms can be amended.

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