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Construction Liens and Loan Advances: Why Prudent Commercial Lenders Hit "Pause" and How to Clear the Path

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Ontario's construction and development sector faces ongoing supply-chain disruptions, labour shortages, and uncertain interest rates, resulting in tighter margins and increased payment disputes. As a result, construction liens under *The Construction Act*, R.S.O. 1990, c. C.30 (the "Act") have become more frequent.

The following discussion explains why caution by mortgage lenders looking to make an advance under their loan is warranted. We also provide an overview of the methods available for removing construction liens ensuring that the loan advance can proceed smoothly.

The Importance of Removing a Lien Before Advancing Funds

Under Ontario law, a registered construction lien purports to create a charge on the subject lands in favour of the claimant. Section 78 of the Act establishes a detailed priority regime that can displace or subordinate later-registered interests, including mortgages. If a lender advances funds after a lien is preserved (i.e., registered), those sums risk ranking after the lien claimant, even where the mortgage was previously registered.

Beyond priority exposure, advancing in the face of a lien can trigger the following hazards:

1. **Breach of loan covenants:** Most credit agreements require a representation that title is clear of liens other than permitted encumbrances. If a lender knowingly advances funds in the face of the lien, they risk inadvertently waiving the default through their conduct.

2. **Impaired collateral value:** The amount secured by the lien must be discharged or otherwise provided for before a typical sale or refinancing can close, reducing both the value of the property subject to the mortgage and exit flexibility for the lender.

3. **Litigation risk**: If a borrower becomes insolvent, a lender who advanced over a lien may face attack from a receiver, trustee, or other creditors.

Common Ways to Remove a Construction Lien

The Act provides several mechanisms - some quick, some contentious - for eliminating a lien. Savvy lenders should know each option's timing, cost, and documentary requirements.

- **Payment in Full**: The borrower pays the full amount claimed, and the lien claimant registers a discharge to remove the lien from title.
- **Posting Security and Vacating the Lien**: The borrower posts cash, a lien bond, or a letter of credit with the Court, covering the lien amount plus required costs. The Court then orders the lien vacated from title, and the dispute continues against the security.
- **Lien Expiry**: If the lien claimant fails to preserve or perfect the lien within the strict deadlines set by the Act, the lien expires and can be removed from title.
- **Court Order Striking the Lien**: The owner can apply to Court to discharge or reduce a lien that is invalid, frivolous, exaggerated, or filed against the wrong property.
- **Settlement or Partial Payment**: The parties negotiate a settlement and the claimant then registers a discharge of the lien.
- **Escrow Loan Advance**: Counsel to the lender and counsel to the lien claimant(s) agree to an escrow arrangement whereby the loan is advanced into escrow with counsel to the lender, counsel to the lien claimant(s) discharge the lien(s) and then lender's counsel releases the funds from escrow to the claimant(s) and any remaining funds to the borrower.

Practical Tips for Lenders

- Demand a clear plan - complete with timelines, counsel undertakings, and draft discharge documents - before approving any "lien-removal advance."
- Include explicit provisions in commitment letters and loan agreements prohibiting advances while any lien is registered, and requiring the borrower to deliver prompt notice of any preserved or perfected lien, together with copies of related pleadings or adjudication notices.
- Insist on a fresh title sub-search immediately prior to any advance.
- Document every step of the lien removal and advance process to create an audit trail demonstrating that the lender acted prudently and preserved its mortgage priority.

Conclusion

Construction liens are an inevitable by-product of today's construction and development industry, but they need not derail a well-structured loan. By understanding the priority issues and other concerns caused by the existence of a lien or liens or title, and the common methods of addressing such lien(s), commercial lenders can safeguard their security, maintain leverage in negotiations, and support borrowers without compromising their own risk profile.

The information contained in this article is intended to provide general guidance on recent developments in secured lending and should not be construed as legal advice. For specific questions or situations, please contact Kym Stasiuk or Rob Hawkins of the Real Estate & Business Group at Blaney McMurtry LLP.