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M.J.B. Enterprises Ltd. v. Defence Construction (1951), [1999] 1 S.C.R. 619 and
Double N Earthmovers Ltd. v. Edmonton (City), 2007 SCC3, [2007] 1 S.C.R. 116-2007-01-25 Supreme Court of Canada

What Mortgage Payments Are "Advances" That Have Priority Over Lien Claims?

A recurring issue for construction and builders liens is whether the liens have priority over mortgage advances. One question which does not often arise is: what sort of payments by a mortgagee do constitute "advances" under a mortgage? In other words, what sort of payments by a mortgagee can even qualify for priority over lien holders?

A mortgagee may make payments for many reasons, but a lien holder may question whether the payment qualifies as an "advance" under the mortgage. For example, when a mortgagee appoints a receiver and loans moneys to the receiver under new arrangements with the receiver, are those loans "advances" under the original mortgage? Are those loans entitled to priority over existing registered lien holders? The British Columbia Court of Appeal recently answered "No" to these two questions in ***Bank of Montreal v Peri Formwork Systems Inc.***

The background:

The Bank was a mortgagee to the owners and developers of the project. On June 21, 2009, it demanded payment of $29 million on the mortgage. On July 21, 2009, the owners obtained an order under the ***Companies' Creditors Arrangement Act*** (CCAA). The order permitted the owner to borrow $2 million in Debtor-in Possession (DIP) financing from the Bank. The order stated that the loan had priority over all other security interests including builders' liens.

On July 28, 2009, Peri Formwork filed a builders' lien.

In December 2009, the CCAA proceedings came to an end. The monitor under the CCAA proceedings was then appointed as receiver of the borrowers. Under the terms of the receivership order, the receiver was permitted to borrow up to $21 million from the Bank. The terms of that loan had different terms than the original mortgage.

The receivership order stated that the receiver's borrowings were to have priority over all other security interests or liens except builders liens filed prior to the date of the order which totaled about $2 million. As to those liens, the order stated that the priority between the receiver's borrowings and the prior liens would be determined in a separate hearing.

The Bank commenced foreclosure proceedings in December 2009. Before the December 2009 receiving order, the monitor's assessment was that, if the property was sold on an "as is" condition, there would be a substantial shortfall for the mortgagee, and that by continuing the construction, a substantially reduced shortfall would likely result.

In April 2010, a judge of the BC Supreme Court held that loans which the Bank proposed to advance to the receiver took priority over the prior liens. This decision was reversed by the BC Court of Appeal. That decision was based on three grounds:

First, the Court of Appeal held that the priority of the loans to the receiver could not be based on the CCAA proceedings and orders. By the time of the mortgage and receivership proceedings, the CCAA proceedings had been "effectively terminated" and there was "no life remaining" in those proceedings.

Second, the Court of Appeal held that there was no inherent jurisdiction of the court to accord priority to the Bank's loans to the receiver that would over-rule the statutory scheme in the ***Builders Lien Act*** (the Act).

Third, the Court of Appeal held that the loans to the receiver could not qualify as "further advances under the mortgage" within the meaning of Section 32(5) of the Act. The Court noted that Section 21 of the Act expressly gives priority to liens over "receiving orders". The Court held that Section 32(5) provides an exception to the priority in favour of lien holders over mortgage advances in Section 32(2). The words in Section 32(5) had to be given a restrictive meaning, and an interpretation which gives effect to the purpose of the Act, which is to "to ensure that contractors and suppliers are paid for materials provided and for services rendered". Accordingly, those words only apply to an advance under the original mortgage. The loans to the receiver were to be under different terms and were distinct loans, and accordingly were not "advances" made under the original mortgage.

Section 32(5) and (6) of the Act states that the mortgagee may apply to the court and obtain an order that its further advances are to be given priority over the registered liens, and that the court must make such an order if it finds that the advances will be applied to complete the improvement and will result in an increased value of the land at least equal to the amount of the proposed advances. The Court of Appeal held that, in light of its decision that the loans to the receiver were not "advances", it did not have to consider whether Section 32(6) applied.

While this decision was made in the context of loans to a receiver, it raises the much broader question about when monies paid by a mortgagee will be given priority over lien holders. Generally speaking, the construction and builders lien Acts across Canada use the words "advance" and "in respect of" or "on account of" the mortgage. For instance, section 78(4) of the ***Ontario Construction Lien Act*** refers to "any advance made in respect of that conveyance, mortgage or other agreement." Section 31 of the ***Manitoba Builders' Lien Act*** refers to "payment or advances made on account of any conveyance or mortgage" Section 23(2) of the ***Nova Scotia Builders' Lien Act*** refers to "funds advanced in good faith", without stating that the advance must be in respect of the mortgage, although that requirement may be assumed.

What may not be obvious in each case is whether the payment made by the mortgage is an "advance" and whether it is "in respect of" or under the mortgage. If it is not, then according to the ***Peri Formwork*** decision, the payment will not obtain priority over competing lien claims.

Construction Liens - Priority - Mortgage advances - Receiver
Tags: priority – foreclosure proceedings – receiver – lien - builders

***Bank of Montreal v Peri Formwork Systems Inc.,* 2012 BCCA 4**

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