



The Adviser *Supplement*

September 1992

Undertakings to discharge mortgages

As part of the Law Society's on-going review of current issues aimed at risk management and loss prevention in the professional practice of law, the Practice Advisory Service has reviewed the February 1981 recommendations respecting the procedure for dealing with the discharge of an existing mortgage at the time of closing a real estate transaction.

The 1981 recommendations stated that when a mortgage to be discharged by the vendor is held by a 'private lender' (being a person or corporation not regarded as one of the regular institutional mortgage lenders), the discharge should be made available for delivery and registration at the time of closing. However, when the mortgage is held by a regular recognized mortgage lending institution, either the vendor's solicitor or the purchaser's solicitor might accept the other solicitor's undertaking to obtain and register the discharge of mortgage after closing providing funds required to pay off the mortgage can be paid by certified cheque drawn by the purchaser (or the purchaser's solicitor) out of the balance of purchase price payable on closing, and certain other safeguards are followed.

These revised guidelines contain new recommendations respecting the discharge of mortgages held as collateral security for revolving credit, as well as additional commentary on the mortgage discharge provisions in sale agreements. The Professional Standards Committee of Convocation has also approved a new definition of the term "institutional mortgage" as used in the guidelines.

Discharge of Mortgage After Closing

Most institutional lenders are still unable or unwilling to make the mortgage discharge available at the time of the closing of a real estate sale. It therefore requires cooperation between the solicitors involved in order to complete the transaction. The common practice is for the

vendor's statement of adjustments to divide the balance on closing to show the amount payable to the lending institution to discharge the mortgage (in accordance with the written mortgage statement delivered to the purchaser's solicitor) and the balance to be paid to the vendor, or to the vendor's solicitor, all in accordance with a written direction signed by the vendor. The purchaser's solicitor issues and certifies cheques in accordance with this

arrangement and delivers them to the vendor's solicitor on closing in return for the vendor's solicitor's undertaking to deliver the mortgage pay-out cheque forthwith to the mortgagee and to obtain and register the required discharge of mortgage without delay.

This procedure continues to be appropriate only in the case of a discharge of a mortgage held by one of the conventional mortgage lending institutions. If the vendor has contracted to deliver clear title on closing, the purchaser's solicitor should insist that the required discharge of a mortgage held by a private mortgagee be produced and registered on or before closing. As a general rule, an undertaking to obtain and register the discharge of a private mortgage at a later date should not be given or accepted.

Contractual Obligations

Many printed forms of Agreement of Purchase and Sale now specifically provide for the giving and receiving at the time of closing of the vendor's solicitor's undertaking to obtain and register a discharge of an existing registered mortgage. Usually this clause is restricted to the discharge of institutional mortgages.

The Practice Advisory Service has become aware of a number of situations in which the Agreement of Purchase and Sale stipulates that the purchaser will accept an undertaking to obtain and register the discharge of a private mortgage after closing. In some cases the agree-

Guidelines relating to undertakings for the discharge of existing mortgages in closing real estate transactions have been revised

ment stipulates that the purchaser will accept the vendor's undertaking rather than the undertaking of the vendor's solicitor. Lawyers representing vendors should recognize that they may not be acting in the best interests of their clients by inserting such clauses in Agreements of Purchase and Sale. They may, in fact, create a situation in which the purchaser is unable to obtain new mortgage funds required to complete the transaction because the purchaser's lawyer, or the lawyer acting for the proposed new mortgagee, cannot give the unqualified certificate of title required to permit mortgage funds to be made available.

If the purchaser's solicitor has the opportunity of reviewing the proposed agreement before the client signs, any such inappropriate provision respecting an undertaking to be given on closing should be corrected or deleted. If the provision respecting an undertaking for the discharge of a mortgage is an enforceable term of a contract already entered into by a client, the lawyer who agrees to act for that client may have no alternative but to complete the transaction in accordance with that term.

As with all other terms of a contract, this provision should be reviewed and explained to the client and if there appears to be any unusual risk to the purchaser in accepting the stipulated undertaking, the purchaser's lawyer should attempt to protect the purchaser's position by all reasonable means. This may include, upon the client's instructions, attempting to negotiate more suitable terms for the discharge of the mortgage while preserving the client's existing rights under the Agreement of Purchase and Sale.

Revolving Credit Mortgages

Special problems arise when the property being sold is subject to a collateral mortgage to secure a revolving line of credit such as those offered by some banks and trust companies which allow preferred customers to draw against that secured credit by credit card or special cheque. The lawyer acting for the owner of the property at the time of sale or refinancing needs to know exactly the amount required to discharge the collateral mortgage as at the transaction date.

However, the mortgagee says it will only confirm, sometimes by telephone on the transaction date, the balance outstanding according to its records as of that date. The mortgagee does not want to discharge the mortgage until a later date, which may be as much as 90 days after the transaction date. If further drawings against the line of credit show up on the customer's account during that period, the mortgagee wants to withhold the discharge of mortgage until those additional charges have

been paid off. The lawyer handling the transaction could not therefore obtain an unqualified statement from the lending institution confirming the exact amount required to obtain a discharge of mortgage. This would put the lawyer in an impossible position. In order to complete the sale of the mortgaged property, the lawyer may be required to give a personal undertaking to obtain and register a discharge. In the case of refinancing, funds under the new mortgage loan will probably be required to pay off the outstanding line of credit but the lawyer must give an unqualified certificate of title to the new mortgagee in order to be able to advance the funds.

If an additional amount were to be demanded by the original mortgagee before the discharge of the collateral mortgage could be obtained, and if the client should be reluctant or unable to pay that additional amount, it would become necessary for the lawyer to make the payment out of his or her own personal funds to obtain the discharge of mortgage required to honour the lawyer's undertaking to the purchaser or the certificate of title to the new mortgagee. Lawyers should not accept this risk.

RECOMMENDED PROCEDURES

The Practice Advisory Service makes the following recommendations:

A. Institutional Mortgages — Full Discharge

For the purpose of these recommendations, the term "institutional mortgage" refers to a mortgage held by a bank, trust company, insurance company, credit union or finance company. The term "private mortgages" refers to mortgages held by other corporations or individuals.

1. Mortgage Discharge Statements — the purchaser's solicitor should write directly to the mortgagee and require that a discharge statement be addressed to him or her. It should be made clear that

- i) the purchaser's solicitor will be relying upon the accuracy of the statement and will be issuing a cheque payable to the mortgagee, to be deducted from the closing funds at the time of completion of the purchase, for the purpose of completely discharging the mortgage;
- ii) the purchaser's solicitor will not be bound by any qualification of the statement whether by use of the abbreviation 'E. & O. E.' or otherwise. The purchaser's solicitor should do everything possible to establish an estoppel against the mortgagee claiming additional funds on the basis of an error in the mortgage statement.

2. *Closing Funds* — On the statement of adjustments, the balance due on closing should be divided to show the amount payable to the mortgagee in accordance with the mortgage pay-out statement and the balance of the funds payable to the vendor or to the vendor's solicitor in trust. A written direction signed by the vendor is required for payment of funds to anyone other than the vendor.

3. *Closing Procedure* — On closing, the purchaser's solicitor delivers to the vendor's solicitor a certified cheque payable to the mortgagee in accordance with the vendor's written direction, together with a covering letter addressed to the mortgagee stipulating that the funds are to be applied to payment of the mortgage debt. The purchaser's solicitor will require the personal undertaking of the vendor's solicitor:

- i) To deliver the cheque and letter to the mortgagee forthwith;
- ii) To be responsible for any additional monies payable for the discharge of the mortgage as a result of any delay in delivery of the discharge of funds; and
- iii) To make every reasonable effort to obtain and register a proper form of discharge of the mortgage as soon as possible after closing.

The purchaser's solicitor will also require the vendor's personal undertaking that the vendor will be responsible for any additional amounts payable to the mortgagee by reason of any error, omission or other change in the mortgage statement.

B. Blanket Mortgages — Development Lands and Condominiums — Partial Discharges

It is still the practice of some land developers and condominium developers to include in their standard printed form of Agreement of Purchase and Sale a provision requiring the purchaser of a lot or unit to accept the vendor's undertaking to register a partial discharge of a "blanket" mortgage after closing of the transaction. Such provision should be deleted from the purchase agreement if the purchaser's solicitor has an opportunity of examining the agreement before it is executed.

If the purchaser does not wish to delete this provision (e.g. - for fear of losing the transaction), such instructions should be reduced to writing immediately, and acknowledged by the client's signature. Consideration might be given to the right of rescission given to a purchaser under Section 52 of the Condominium Act.

When acting in a transaction pursuant to an Agreement that contains such a provision, the following proce-

dures should be carefully considered:

- i) Insist on a partial discharge before closing.
- ii) Pay the funds to the vendor's solicitor in return for a personal undertaking to obtain and register a partial discharge.
- iii) Make the cheque payable to the developer and mortgagee jointly or to the mortgagee and obtain a partial discharge.
- iv) At the very least, find out the amount required to obtain a partial discharge and try to obtain one directly from the mortgagee.
- v) Refuse to close and tender, though this might be unrealistic for practical reasons.

It is recommended that a combination of items i) and iv) might be the best course. In the letter of requisitions the vendor's solicitor should be advised that, notwithstanding the provision in the agreement, a partial discharge will be required to be available for registration at the time of completion of the transaction. The purchaser's solicitor might advise that, as an alternative, he or she will accept a statement addressed to him or her from the mortgagee to confirm the amount required for the partial discharge and that a partial discharge in registrable form will be delivered immediately upon receipt of the funds. The purchaser's solicitor should then follow the procedures outlined above in relation to full mortgage discharges on closing.

Reference should also be made to Subsections (9) and (10) of Section 7 of the Condominium Act which give a right to discharge any unit from an encumbrance by payment to the claimant of a portion of the sum claimed, determined by the proportion specified in the Declaration for sharing the common interests.

C. Discharges of Revolving Credit Mortgages

1. At the time a collateral mortgage is given to secure revolving credit, the borrower client should be informed that special arrangements to discharge the mortgage may have to be made if the property is to be sold or refinanced. The client should be advised not to enter into an agreement to sell the property until appropriate arrangements can be made to discharge the mortgage.

2. Before a solicitor agrees to act on the sale of property which is subject to an institutional mortgage securing revolving credit, it must be explained to the client that the solicitor may be required to give his or her personal undertaking to obtain and register a discharge of the mortgage and a solicitor cannot give such an under-

taking without first receiving from the mortgagee a written statement showing the exact amount required to pay off the mortgage on the transaction date. The client should therefore get in touch with the lending institution immediately to make whatever arrangements may be required to permit the necessary mortgage pay-out statement to be obtained by the solicitor. This will probably require the immediate surrender to the lending institution of all credit cards and special cheques relating to the line of credit.

3. In the letter to the mortgagee requesting a statement showing the amount required to discharge the collateral mortgage as of the transaction date, the solicitor should emphasize that a written mortgage statement is required and that the lawyer will have to rely on that statement as showing the exact and only amount required to obtain a discharge of the mortgage because additional funds may not be available after the transaction date. Any attempt by the mortgagee to qualify the written statement, whether by use of the abbreviation "E. & O.E." or otherwise, will be unacceptable.

4. If there is any reluctance on the part of the mortgagee to give the required unqualified mortgage statement, it could be suggested that any drawings against the line of credit which do not show on the client's account at the time the statement is prepared might be included in the unsecured line of credit for that client and should not therefore prevent the issue of the required discharge of mortgage.

5. Failing that, it may be necessary for the client to authorize the solicitor to pay the full balance of the proceeds of the sale (after payment of prior encumbrances and deduction of real estate commission, legal fees and expenses) to the mortgagee to be held and applied for the credit of the client in return for an agreement by the mortgagee to provide a discharge of the collateral mortgage. This would, of course, mean that no proceeds from the sale would be available to that client on the transaction date for the purchase of other property or for any other purpose.

6. As an alternative, the client and the solicitor may be able to negotiate an agreement with the mortgagee that if the proceeds of the sale are immediately applied to the purchase of other property, the existing collateral mortgage held by the mortgagee will be replaced at the time of closing by a new mortgage on the property purchased and

that upon receipt of the new mortgage the mortgagee will issue a discharge of the original mortgage on the property which has been sold.

7. The solicitor acting on the sale of property which is subject to an institutional mortgage securing a revolving line of credit should not give an undertaking to discharge that mortgage unless he or she has received the client's written direction to pay out of the proceeds of the sale the exact amount required to discharge the mortgage as shown by an unqualified mortgage statement obtained by the solicitor from the mortgagee, or arrangements have been made, confirmed in writing and approved by the client, that the mortgagee will provide a discharge of the mortgage on receipt of all of the net proceeds of the sale or a replacement mortgage on other property.

D. Discharges of Private Mortgages

As previously mentioned, it is usually inappropriate to give or accept an undertaking to obtain and register a discharge of a private mortgage after closing. Subject to any provision in the Agreement of Purchase and Sale which may affect the purchaser's right to demand clear title on closing, the purchaser's solicitor should require the production and registration of a discharge of a private mortgage on or before closing.

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THE LAW SOCIETY OF UPPER CANADA

REAL ESTATE TRANSACTIONS -

UNDERTAKINGS ON CLOSING -

MORTGAGE DISCHARGES

20 February 1981

The Practice Advisory Service has reviewed current procedures for dealing with the discharge of existing mortgages at the time of closing a real estate transaction. Contributions have been made by a number of individual lawyers who are regarded as highly qualified in real estate practice, the Real Property Section of the Canadian Bar Association-Ontario and by Joan Morham of Maltman & Company (the Law Society's Insurance Adjusters). Following the background information and outline of risks are recommendations which are submitted to the Profession as guide-lines to be followed in the circumstances outlined. The recommendations are an attempt to set a general standard, but individual situations may indicate the need for variation or an entirely different approach. It remains the responsibility of the individual lawyer to choose and recommend to his client the procedure best suited to the individual transaction. Reference should always be made to the extensive published material now available concerning the avoidance of risks in real estate transactions, particularly as this material refers to Undertakings on closing (e.g. the Law Society Risk Management Handbook, pages 135 to 138).

BACKGROUND

In the past the general practice has been that the Vendor's Solicitor would deliver to the Purchaser's Solicitor on closing a written undertaking to withhold from the balance due on closing sufficient moneys to pay off and discharge any existing mortgage, remit the same to the mortgagee and attempt to obtain and register a proper form of discharge of mortgage as soon as possible after completion of the transaction. These undertakings were normally essential, and accepted by Purchaser's Solicitor, when the mortgagee was one of the regular recognized mortgage lending institutions (i.e. Banks, Trust Companies, Insurance Companies etc.).

If the mortgagee is what is referred to as a "private lender", being a person or corporation not regarded as one of the regular institutional mortgage lenders, the general practice is to require that the discharge be available for delivery and registration at the time of closing of the real estate transaction. This procedure should be continued when a discharge is required from a "private lender".

The problem is that it is difficult and practically impossible to have institutional lenders make their mortgage discharges available for closing of a real estate transaction. They will co-operate in this regard if the transaction is likely to be in jeopardy for want of the discharge being available on closing. However, as a general rule, a lending institution will not prepare its mortgage discharge until after the funds have been received and credited to the mortgage account. This situation gives rise to a practice whereby either -

- (a) The Vendor's Solicitor gives an undertaking to withhold and remit moneys to discharge the institutional mortgage and attempt to register a proper form of discharge as soon as possible after closing, or
- (b) The Purchaser's Solicitor requires that the Statement of Adjustments divide the balance due on closing to show the amount payable to the mortgagee to discharge its mortgage in accordance with a written mortgage discharge statement delivered to the Purchaser's Solicitor and the balance to be paid to the Vendor or his Solicitor, all of which should be according to a written direction from the Vendor. The Purchaser's Solicitor issues cheques accordingly and delivers them to the Vendor's Solicitor in return for his undertaking to deliver the cheque forthwith to the mortgagee.

RISKS

Some of the risks involved in these mortgage discharge situations are as follows:-

1. If the Purchaser's Solicitor accepts the undertaking of the Vendor's Solicitor to withhold funds and discharge:-
 - (a) The Vendor's Solicitor may find that he does not have sufficient funds to discharge all encumbrances.
 - (b) The Vendor's Solicitor may fail to remit the required funds to the mortgagee, either through oversight or by misappropriation.
 - (c) The mortgage statement might be in error and the mortgage company might demand additional funds which are not available.
2. If adjustments are drawn, and direction received with accompanying mortgage discharge statement, so that the Purchaser's Solicitor issues a separate cheque to the mortgagee to discharge its mortgage:-

- (a) If the Purchaser's Solicitor delivers the mortgage discharge cheque to the Vendor's Solicitor in return for his undertaking to deliver the cheque to the mortgagee then:-
- (i) if the Vendor's Solicitor delays delivery of the cheque to the mortgagee, substantial added interest charges may have accrued by the time the situation could be corrected, at which time it might be difficult or virtually impossible to recover the added charges from the Vendor. (Also consider the possibility that the mortgage discharge statement has made some special considerations as to waiver or reduction of prepayment bonus on the understanding that the mortgage would be repaid in full on the sale closing date), or
 - (ii) between time of delivery of the discharge statement to the Vendor's Solicitor and receipt of payment the mortgagee finds an error and demands additional funds before preparing and delivering the discharge.
- (b) If the Purchaser's Solicitor undertakes to deliver the discharge cheque to the mortgagee (rather than have the Vendor's Solicitor do so), then:-
- (i) the mortgagee may find an error in its discharge statement and refuse to prepare and deliver a discharge until it receives additional funds.
 - (ii) for the Vendor's Solicitor there is the risk that the Purchaser's Solicitor fails to deliver the cheque to the mortgagee promptly, or fails to do so altogether, with the possibility that the Vendor would have continuing liability to the mortgagee under the mortgage covenant for payment.