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Lenders Should Think Twice Before Foreclosing on Sympathetic Mortgages

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Many mortgage enforcement actions proceed through Ontario courts every day. When mortgagees are not paid in accordance with the terms to which they have agreed with the mortgagor, they have a number of options open to them. These options include foreclosure and power of sale proceedings.

There is often a sympathetic human element involved in mortgage enforcement proceedings where the collateral is the mortgagor's residence. However, the law is not traditionally seen as overly sympathetic. Lenders may believe that their legal rights in the event of default include foreclosure, and that this should not change depending upon the identity of the mortgagor. Generally, they would be right. However, the law is administered by humans and it allows – and often calls for – judges to reach decisions that they consider just on the facts, rather than applying a set of rules robotically.

The recent decision of the Court of Appeal for Ontario in *Winters v Hunking*, 2017 ONCA 909 provides an example of the court acknowledging that the mortgagor may have been within its strict legal rights to seek foreclosure on the appellant's home, but finding that "special circumstances" made such a foreclosure unjust in the circumstances.

As noted by Blair J.A. who penned the Court's decision, there were two very different sides to the factual story before the court. First, the appellant, Mr. Hunking, had borrowed \$350,000 from the respondents and used his family homestead as security. He made no payments on the mortgage. He failed to pay his taxes as he had agreed. He failed to respond to the foreclosure action commenced by the respondents and was eventually noted in default, leading to default judgment being entered against him. In short, the court found that he "did everything wrong."

However, the other side of the story was that the appellant was a 61-year old bachelor in ill health. He was illiterate, low-income and was physically disabled. He required daily doses of morphine for chronic pain, which affected his reaction time and ability to respond to circumstances. The mortgaged property was his family farm, which had been passed down to him from his parents, and to them from his grandparents. The appellant's doctor described him as "severely mentally challenged" with "significant cognitive impairment." At one time in 2013, he had purchased a small herd of 16 cattle to live on his farm, but all but two of them perished when he "forgot to feed them."

The appellant's personal circumstances were deserving of a measure of sympathy. If nothing else, they provided a potential explanation for his failure to respond in a reasonable way to the foreclosure proceeding

The issue before the motion judge was whether to set aside default judgment ordering foreclosure on the appellant's property. The financial evidence on the motion showed that the farm's estimated value was at least \$250,000 more than the indebtedness owed to the mortgagees. However, the motion judge refused to set aside the default judgment. The test on whether to set aside a default judgment is discretionary. The motion judge was simply not persuaded that the facts before him justified exercising his discretion to set the default judgment aside.

The Court of Appeal came to the opposite conclusion. It conceded that the motion judge touched on the appropriate legal principles and factors, and that he accurately reviewed the background facts. Justice Blair wrote that he would generally "be disinclined to interfere with the exercise of discretion in such a case." However, interfere he did. He justified overturning the motion judge's decision by noting four errors (he declined to classify them as either errors of principle or mixed fact and law, given that the proper classification would not affect the result):

1. The motion judge mischaracterized the appellant's mental frailties. He considered them in relation to the appellant's ability to participate in the legal proceedings, but did not consider them as a potential explanation for the appellant's conduct.
2. The motion judge did not adequately consider the substantial equity that would remain in the property after the mortgagees were paid.
3. The motion judge focused on the appellant's refusal to repay the mortgage by refinancing, rather than considering the ability to repay the mortgage by selling the property.
4. The motion judge failed to analyze the "true nature and significance" of the windfall to the mortgagees.

While the Court identified these as errors of the motion judge, one could argue that the decision is one where the Court of Appeal was really re-balancing the discretionary factors and coming to a different conclusion than the motion judge. And on the facts of this case, it is hard to criticize the ultimate result. As the Court noted, there was virtually no prejudice to the respondents in setting aside the foreclosure order and ordering a judicial sale instead. The evidence was that the respondents would be paid in full, including interest, from the proceeds of sale. However, if the foreclosure order was not set aside, the mortgagor would suffer the prejudice of losing the extra equity – at least \$250,000 – built up in the property since his grandparents owned it, and there would be a corresponding windfall to the mortgagees.

The Court of Appeal set aside the motion judge's decision, ordered a judicial sale of the property, and awarded costs of the appeal and the motion below to the mortgagor.

The decision serves as a reminder to lenders, commercial and otherwise, that a foreclosure order is not a guarantee on default. Courts may weigh the relative equities and prejudices to the parties, and a sympathetic mortgagor may convince a court to refuse to grant a foreclosure order, a decision that can carry with it significant costs – legal, financial and temporal – that lenders would prefer to avoid.

WeirFoulds LLP - Scott McGrath

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