

CAN A MORTGAGEE-IN-POSSESSION GET “OUT OF POSSESSION”?

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Once upon a time, a mortgage of land was created by a landowner/borrower (hereafter referred to as the “chargor”) delivering to the mortgagee the actual paper deed to the mortgaged property.¹ The right to possession of the mortgaged property automatically was transferred by the chargor to the mortgagee as a consequence of the deed having been delivered.² Right through to the 1980s, the common law in Ontario continued to recognize a mortgagee's inherent right to possession of the mortgaged property.³ But virtually every modern mortgage and charge now includes a covenant permitting the chargor to remain in possession of the mortgaged property until a default occurs under the mortgage.⁴ The Land Registration Reform Act recognizes this reality of modern mortgage practice and gives the mortgagee, *upon default*, the right to “enter on and take possession of, receive the rents and profits of, lease or sell the land”.⁵

Historically, English Courts of Law only required the mortgagee to return the legal title to, and actual possession of, the mortgaged property to the chargor if all of the covenants (including the covenant to repay the debt) were performed and fulfilled by the chargor exactly as agreed upon in the mortgage document.⁶ The chargor was at the mercy of the

¹ R. McGarry and H.W.R. Wade, *The Law of Real Property*, 4th ed. (London: Stevens & Sons Limited, 1975) at p. 888.

² G.W. Dunn and W.S. Gray, *Marriott and Dunn: Practice in Mortgage Remedies in Ontario*, 5th ed. (Toronto: Carswell, 1995) at p. 46-2.

³ *Ibid.*, at p. 46-3.

⁴ *Ibid.*, at p. 46-3.

⁵ R.S.O. 1990, c. L.4, s. 7(1)1.v.

⁶ *The Law of Real Property*, at p. 888.

mortgagee if there was any default under the mortgage, because the absolute conveyance to the mortgagee of the mortgaged property (that created the mortgage) left the chargor with no recourse against the mortgagee. The Courts of Law sanctioned the mortgagee's permanent retention of title to and possession of the mortgaged property if the chargor was unable to fulfill the mortgage covenants or otherwise was unable to repay the mortgage debt strictly in accordance with its terms.⁷

The Courts of Equity found a solution to the harshness sanctioned by the Courts of Law. This solution would come to be known as the chargor's equity of redemption. Courts of Equity gave the chargor an opportunity to redeem the mortgage and to regain possession and title to the mortgaged property, even after a breach of covenant, if the chargor was able to repay in full the mortgaged debt.⁸

It is the chargor's right of redemption, and the mortgagee's obligation to be in a position to return possession of the mortgaged property to the chargor, that underlies the rationale for the imposition of strict duties and obligations on a mortgagee who takes possession of a mortgaged property after default.⁹

After default, a mortgagee may exercise its right to take possession of the mortgaged property by becoming a mortgagee-in-possession. The determination of when a mortgagee becomes a mortgagee-in-possession is a subject worthy of its own paper. For our purposes, it is suffice to say that a mortgagee becomes a mortgagee-in-possession when

⁷ Ibid., at p. 888.

⁸ Ibid., at p. 889.

⁹ W.M. Traub, *Falconbridge on Mortgages*, 5th ed. (Toronto: Canada Law Book Inc., 2003) at p. 32-8.

the mortgagee takes the control and management of the mortgaged property out of the hands of the chargor.¹⁰

Once a mortgagee has become a mortgagee-in-possession, the mortgagee must act as would a prudent owner.¹¹ As such, the mortgagee-in-possession must ensure that the mortgaged property remains reasonably well-maintained and available for return to the chargor. The mortgagee-in-possession is liable for rents and profits emanating from the mortgaged property. This means not just the revenues it actually collects, but also the revenues “it might have received but for its negligence or mismanagement.”¹²

And now we turn to the meat of this topic. Once in possession, can a mortgagee-in-possession get out of possession so as to be relieved of all these future obligations and liabilities? And if so, how?

The law is clear that a mortgagee-in-possession cannot simply vacate the mortgaged property in order to avoid the responsibilities it has taken on.¹³ Having said this, the Ontario Court of Appeal has held that in order to go out of possession, a mortgagee need not attain the leave of the court.¹⁴ It is also self-evident that a mortgagee-in-possession may give up possession and relieve itself of the corresponding ongoing obligations and liabilities if the consent of the chargor is obtained.

¹⁰ *Marriott and Dunn*, at p. 46-11 and p. 46-14.

¹¹ *Ibid.*, at p. 46-28.

¹² *Falconbridge on Mortgages*, at p. 32-10.

¹³ *Ibid.*, at p. 32-8.

¹⁴ *Investors Group Trust Co. Ltd. v. K-P-T Properties Inc.* (1996), 1 R.P.R. (3d) 20 (Ont. C.A.) at para. 6.

The mortgagee-in-possession will also be entitled to relieve itself of future liability as such in the event that a party with a higher estate in the mortgaged property enforces its right of possession, thereby preventing the mortgagee from continuing as a mortgagee-in-possession. This type of scenario arises both when the chargor redeems the mortgage, and also when a higher ranking mortgagee takes possession of the mortgaged property from the mortgagee-in-possession.

The other common way in which a mortgagee-in-possession can get out of possession without ongoing liability, is by the completion of the sale of the mortgaged property under its power of sale.¹⁵ When the property is sold, possession is transferred to the buyer, and since at the time of the completion of the sale the chargor's right of redemption has come to an end, equity does not require that the mortgagee have any ongoing obligations.¹⁶

Finally, a mortgagee-in-possession can physically get out of possession by assigning the charge and delivering possession to the assignee. But what of the obligations and liabilities of the mortgagee-in-possession in that case? Needless to say, the consent of the chargor will relieve the mortgagee-in-possession of further obligation and liability. But what happens when the consent of the chargor is not available?

Subsection 2(1) of the Mortgages Act provides that a mortgagor, on payment in full of the mortgage debt, may require that a mortgagee assign the mortgage rather than provide a discharge of it.¹⁷ However, subsection 2(3) of the Mortgages Act specifically excludes a

¹⁵ *Marriott and Dunn*, at p.46-29.

¹⁶ *Ibid.*, at p. 46-48.

¹⁷ R.S.O. 1990, c. M.40.

mortgagee-in-possession from this obligation to provide an assignment on demand of the mortgagor. The reason for this exclusion is that a mere assignment of the mortgage does not relieve the mortgagee-in-possession of its ongoing obligations and liabilities. In fact, a mortgagee-in-possession may even continue to be liable for future rents and profits emanating from the mortgaged property after the assignment of the mortgage. For instance, if the assignee mortgagee mismanages the rental income from the mortgaged property, the original mortgagee-in-possession (assignor) will continue to be liable to the chargor for such future rents and profits.¹⁸

In my practice, I use section 2(3) of the Mortgages Act as a club to allow me to require that the assignee mortgagee (who is looking for an assignment of the mortgage) delivers the consent and release of the chargor and also provides its indemnity to the assignor/mortgagee-in-possession as a precondition to the assignment of the mortgage. Doing so gives the mortgagee-in-possession the best of both worlds: repayment of its mortgage debt, as well as a release from the chargor for all liabilities incurred as mortgagee-in-possession.

Going out of possession is not a complicated process. A mortgagee-in-possession may go out of possession and have no ongoing liability to the chargor when:

- the chargor provides its consent
- the chargor redeems the mortgage
- another mortgagee takes possession under its higher ranking mortgage
- the closing of the sale of the mortgaged property under power of sale occurs

¹⁸ *Falconbridge*, at p. 32-8.

The mortgagee-in-possession may also assign the mortgage to another lender, but not without the risk of remaining liable for future misdeeds of the assignee. Caution and appropriate consents, releases and indemnities are strongly recommended.