

Weisleder: How to protect yourself when buying a home from a bank

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When a mortgage goes into default in Canada, the most likely remedy that the lender will pursue is power of sale.

This is a right contained in every mortgage and permits the bank to sell the property to recover the amount owing.

If there are insufficient funds from the sale to pay the debt, the bank can sue the borrower for the difference. If the sale yields excess funds, the bank must send the extra money to the borrower. For example, if the mortgage debt is \$250,000 and the bank sells the property, pays all the expenses and is left with \$225,000, the bank can sue the borrower for \$25,000. If the bank nets \$300,000, the bank sends \$50,000 to the borrower.

How does a power of sale work? In Ontario, once a mortgage has been in default for a minimum of 15 days, the lender may issue a power of sale notice. This is like a warning and gives the owner 35 days to put the mortgage into good standing. If the owner fails to pay the arrears, the lender has the right to list and sell the property. During the 35 days, the lender is not permitted to take any steps to sell the property, including having the house appraised, sign any listing agreement or advertise the property for sale.

Lenders have a legal obligation to act reasonably in obtaining a fair price for the property. The law indicates that on the date the lender signs an unconditional agreement of purchase and sale with a buyer, the original borrower has no further legal right to pay off his mortgage. But the borrower's rights may be extended by the lender in certain circumstances.

If you try to buy a home under power of sale from a bank, you'll face two difficulties. First, the bank will always include a provision that the home is being sold on an "as is" basis and that they accept no responsibility for any damage or missing items that may occur before closing. In addition, if there is a tenant on the property, they give you no guarantees as to what the lease with the tenant contains. Finally, they will usually add a provision stating that if the original borrower comes up with the money to pay off the mortgage in full on or before closing, they get their house back. You'll be in a very difficult position if you've already sold your current house.

The banks include this final provision to protect themselves against a lawsuit from the borrower who may claim that the bank sold the property too cheaply.

When you buy from a bank under power of sale, it is most important to make the transaction conditional on a home inspection report and, if possible, an up-to-date survey of the property. That is because in most power of sale deals, you'll receive no real disclosure. Also include a pre-closing visit so that you can check the status of all appliances and systems right up until closing.

Sometimes a property may be listed by both the borrower's listing agent and the lender's listing salesperson. In other words, two different brokerages are trying to sell the same property at the same time, one on behalf of the owner and the other on behalf of the bank. If you face this choice, I recommend that you make your offer to the owner, but make it conditional on the lender providing its consent as well. You won't have to accept an "as is" clause, since the owner can control the property until closing, and you won't have to worry about losing the property on the last day if the owner comes up with the arrears.

If you are buying directly from a bank in a power of sale and the bank insists on the clause permitting the borrower to pay up the mortgage loan up until closing, then I recommend that you close the transaction as quickly as possible, once you have completed all of your required inspections, to reduce the risk of your losing the property just prior to closing.

By understanding what is involved in a power of sale transaction, buyers can safely protect themselves from unwelcome surprises, either just prior to or immediately after closing.

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