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MORTGAGE INVESTMENT ASSOCIATION OF BRITISH COLUMBIA ANNUAL LEGAL REPORT, 2012

Presented at the Mortgage Investment Association of BC's Annual General Meeting

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By RBS Lawyers

MIABC ANNUAL LEGAL REPORT

Annual General Meeting – July 17, 2012

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LEGISLATIVE UPDATE

A. New Legislation in Force / Practice Changes

1. Amendments to Section 10 of the Canada Interest Act – Prepayment Rights

Section 10(1) of the Canada Interest Act grants borrowers a statutory right to prepay mortgage loans with terms over 5 years at the end of 5 years upon payment of 3 months' interest, even if the mortgage is expressed to be closed or prepayable only with yield maintenance.

Up until January 1, 2012, the only exemption to this prepayment right contained in the legislation was for mortgages granted by joint stock companies and other corporations, which could consequently be locked into long-term mortgages indefinitely. However, individuals and other non-corporate entities were entitled to the benefit of the prepayment rights in Section 10(1).

The limited scope of the exemption came under increasing criticism over the years as outdated and as

preventing other sophisticated commercial entities increasingly common in the business world (such as partnerships and real estate investment trusts), from negotiating their own prepayment terms to obtain more favourable long-term lending arrangements.

The list of entities that are exempted by statute from the prepayment rights in Section 10(1) has now been expanded with the coming into force on January 1, 2012 of the "Prescribed Entities and Classes of Mortgages and Hypothecs Regulations" (the "Regulations"). Pursuant to the Regulations, the statutory prepayment rights will not apply to mortgages granted after January 1, 2012 by:

- partnerships (including general and limited partnerships the latter arguably exempt at common law prior to January 1, 2012);
- trusts settled for business or commercial purposes;
- Alberta unlimited liability corporations;
- British Columbia unlimited liability companies; and
- Nova Scotia unlimited companies.

Lenders should continue to use caution in structuring long-term mortgage loans involving individuals, trusts established for non-business or non-commercial purposes, or any other non-corporate entities not specifically exempted in the Regulations from the prepayment rights in Section 10(1).

2. Amendments to the BC Strata Property Act – Depreciation Reports

Some important amendments to the Strata Property Act that were contained in the Strata Property Amendment Act, S.B.C. 2009, c. 17, have now come into force by BC Reg. 238/2011 effective December 14, 2011.

There is now a new legislative requirement for strata corporations to obtain a depreciation report by December 13, 2013 prepared by a "qualified person" as broadly defined in the Act, and to obtain a new depreciation report every three years. A depreciation report is a comprehensive inventory and evaluation of the common property and common assets of the strata corporation, the expected timeline for maintenance, repair and replacement over the next 30 years, the anticipated repair and replacement costs, and options for funding payment of such costs. Strata corporations with fewer than five strata lots and strata corporations that pass an annual ¾ resolution waiving the requirement for a depreciation report are exempt.

The legislative amendments also require that the most recent depreciation report be disclosed in a Form B Information Certificate ("Form B") issued by the strata corporation. Form B's are a form of estoppel certificate typically obtained by purchasers, mortgage lenders and mortgage insurers as part of their due

diligence to confirm, among other things, whether there are any strata fees or special assessments outstanding in respect of a strata lot, the owner's liability for future special assessments, and the amount in the contingency reserve fund. The new requirement to attach the depreciation report to the Form B will provide a useful tool for purchasers, mortgage lenders and other interested parties to assess property asset value and the future liabilities of the strata lot owner. For existing owners, depreciation reports, although probably costly, will ensure that future needs are assessed and make the future cost of ownership more predictable.

3. Amendments to Mortgage Insurance Qualification Rules

On June 21, 2012, the federal government announced four measures to tighten the qualification rules for government-backed mortgage insurance, which federally regulated lenders are required to obtain on mortgage loans in which the homebuyer has made a down payment of less than 20% of the purchase price. The changes are intended to cool the housing market and limit the high levels of personal debt that Canadians have accumulated in recent years.

The changes took effect on July 9, 2012 and are as follows:

- The maximum amortization period for a new government-insured mortgage has been reduced from 30 years to 25 years.
- Government-insured mortgages will now only be available on homes with a purchase price of less than $1 million.
- The maximum refinancing amount has been reduced from 85% of home value to 80% of home value.
- Households will be limited to a maximum gross debt service ratio (measured as the share of borrower's gross household income that is needed to pay for home-related expenses) of 39%, and a maximum total debt service ratio (measured as the share of borrower's gross household income that is needed to pay for home-related expenses and all other debt obligations) of 44%.

4. Update on Mandatory Electronic Filing of Land Title Documents

The mandatory electronic filing ("efiling") initiative of the Land Title and Survey Authority of BC (LTSA) began on July 1, 2011 with the requirement that all posting plans be efiled. Since then, mandatory efiling has been expanded as follows:

- As of January 16, 2012, all Form A Transfers (fee simple), Form B Mortgages and Form C Charges (without plans) and Releases must be efiled.
- As of May 7, 2012, most remaining land title documents and plans must be efiled, including claims

of builders lien, forms and applications under the Strata Property Act, all Form 17 documents (e.g. name changes, judgments, notices of interest under the Builders Lien Act), and any plan not requiring local government or provincial approving officer approval such as reference, explanatory and statutory right of way plans.

The LTSA announced on June 8, 2012 that the final phase of efiling will become effective on November 1, 2012, at which time mandatory efiling will be extended to all plans requiring local government or provincial approving officer approval. Some exemptions to the mandatory efiling requirements which have been established for the general public, governments and certain other groups will continue into the final phase of efiling.

5. The new Canada Not-For-Profit Corporations Act, S.C. 2009, c. 23

Prior to October 17, 2011, all federally incorporated not-for-profit organizations, including federally incorporated charities, were incorporated under and subject to Part II of the Canada Corporations Act. On October 17, 2011, the new Canada Not-for-Profit Corporations Act came into force, replacing Part II of the Canada Corporations Act. All existing federal not-for-profit corporations are required to transition to the new regime by filing an application for a certificate of continuance by October 17, 2014, or they will be dissolved.

The new Act serves to reduce government discretion over incorporation, enhance corporate power and capacity to that of a "natural person" (similar to business corporations), and update the corporate governance standards closer to a pure corporate model.

The Act classifies corporations as either "soliciting" or "non-soliciting". Generally speaking, a soliciting corporation is one that receives in excess of $10,000 in a given year from public sources including donations from third parties and financial assistance from all levels of government. A "non-soliciting corporation" is a corporation that is, quite simply, not a soliciting corporation. The new Act imposes stricter requirements on soliciting corporations, particularly with respect to financial reporting obligations, the rationale being that because they receive public funding over a certain minimum threshold, they should be more accountable to the public for the use of those funds. In addition, members are granted more comprehensive rights under the new Act, such as the ability for voting members to requisition meetings, the ability to access corporate records to monitor the board's performance, and the right of non-voting members to vote as a separate class in resolutions that affect their membership rights.

The new Act also streamlines the provisions relating to borrowing powers. The directors are permitted, without member authorization, to borrow money on behalf of the corporation and grant security, unless the articles, bylaws or a unanimous member agreement otherwise provide. Under the old Act, borrowings

needed to be authorized by bylaw and sanctioned by at least two-thirds of the votes cast at a members' meeting.

B. Proposed Legislation

1. Proposed Amendments to the BC Society Act

In December, 2011, the Ministry of Finance released a Discussion Paper outlining its proposed amendments to the Society Act, which governs the majority of charities and non-profit organizations in BC. Legislation to amend or replace the Act is targeted for 2013 at the earliest.

The Discussion Paper contemplates modernizing the Society Act by adopting into the current framework, some of the more modern corporate law provisions contained in the Business Corporations Act, while retaining many existing Society Act provisions in recognition of the distinctive role played by societies.

Some of the proposed amendments that will be of interest to mortgage lenders and their solicitors are:

- lowering the threshold for passage of special resolutions of the members from a 3/4 vote to a 2/3 vote, which will facilitate decision-making and harmonize the Act with other modern corporate legislation;
- removing the requirement for special resolutions of the members to authorize the granting of debentures (broadly interpreted by some lenders to include any type of security taken on the assets of the society); and
- removing the requirement to file all special resolutions at the corporate registry.

The Discussion Paper recommends retaining many existing Society Act provisions which reflect the special nature of societies, for example, the current core restriction on distribution of earnings or other assets to members, the requirement for an annual general meeting with no ability to waive, and the requirement for the preparation of financial statements with no ability to waive.

2. "Community Contribution Companies" – Proposed Amendments to the BC Business Corporations Act

On March 5, 2012, the provincial government announced amendments to the BC Business Corporations Act which will allow for the creation of a new hybrid type of share capital corporation known as a "Community Contribution Company" or "C3". C3's will be structured so as to combine socially beneficial purposes with a restricted ability to distribute profits to shareholders to be determined by regulation. A C3 will be required

to have the words “Community Contribution Company” or the abbreviation “CCC” as part of its name.

The proposed amendments are part of Bill 23, Finance Statutes Amendment Act, 2012, which passed third reading in the legislature on April 25, 2012 and received Royal Assent on May 14, 2012. The amendments will come into force by regulation, although it is not clear when.

According to the Information Bulletin released by the Minister of Finance, C3’s will allow for an alternative business model not currently available through a regular for-profit company or a non-profit society, which will respond to an emerging demand for socially focussed investment options. C3’s are intended to facilitate revenue generation by non-profit organizations, which is becoming increasingly relevant in the current environment of cash-strapped governments and reduced government funding of the non-profit sector.

Under the proposed legislation, one or more of the primary purposes of a C3 must be community purposes (as defined in the legislation) which must be set out in the articles. C3’s will be subject to a higher degree of accountability than an ordinary for-profit company and will be required to publish an annual “community contribution report” detailing the company’s social spending, the amount of dividends declared that year, and other information required by the Act. C3’s will also be subject to an “asset lock” meaning that on dissolution, distributions of the C3’s money and other assets to investors will be restricted. The new rules do not presently contemplate any type of special tax benefit to the C3.

3. The new BC Limitation Act (Bill 34 – 2012)

The Limitation Act sets out the time limits for filing civil lawsuits in BC. Although specific limitation periods for particular claims are set by other legislation (e.g. Insurance Act, Wills Variation Act), the Limitation Act sets the default regime for civil claims including breach of contract, wrongful dismissal, personal injury, defamation and other civil actions.

On April 26, 2012, the new Limitation Act for BC passed third reading in the legislature and received Royal Assent on May 14, 2012. The new Act will repeal and replace the current Limitation Act which dates back to 1975, and is intended to streamline the system and align it with limitations statutes in other provinces that have modernized their limitations laws. The new Act will come into force by regulation, although it is not clear when.

A key change brought about by the new Act is to create a single 2-year basic limitation period for all civil claims. This will replace limitation periods of between 2 and 10 years under the existing Act depending on the type of claim. Exceptions to the 2-year basic limitation period are civil claims that enforce a monetary judgment (which will have a 10 year limitation), claims that have limitation periods set by other legislation,

and certain other exceptions as set out in the Act. The new Act will also move from a general 30-year ultimate limitation period to a 15-year ultimate limitation period.

Of particular interest to lenders is the change from a 6-year limitation period under the current Act, to a 2-year limitation period under the new Act, for obligations payable on demand, such as a demand loan or demand promissory note with no fixed date for repayment. Although the new Act shortens the limitation period to 2 years, it clarifies that the limitation period will only commence on the first day that there is a failure to perform the obligation after a demand for performance has been made, which will provide greater certainty and fairness to the parties. Under the current Act, the 6-year limitation period to collect on a demand obligation has been consistently interpreted by the courts as commencing when the money is lent or the promissory note is made, regardless of whether a demand is ever made. This well-settled common law principle has the potential to result in injustice to unwary parties, particularly in the case of promissory notes made between non-commercial parties or between family members where payment is not expected for many years.

4. Proposed Transitional Rules for Elimination of HST

In August, 2011, Elections BC released the results of the referendum held by British Columbians to extinguish the HST, in which 54.73% voted to revoke the HST. The provincial government subsequently announced that BC will transition back to its former combined PST and GST system, with PST at the rate of 7% and all permanent PST exemptions reinstated.

To implement this, the government introduced Bill 54, the Provincial Sales Tax Act which reinstates the 7% PST effective April 1, 2013, essentially as it was before implementation of the HST. The transitional rules for newly built residential housing are contained in Bill 56, the New Housing Transition Tax and Rebate Act. Both of these Bills passed third reading in the legislature and received Royal Assent on May 31, 2012. They are not yet in force and will come into force by regulation, although it is not clear when. The transitional rules attempt to ensure comparable tax treatment among purchasers during the transition from the HST back to the PST and thereby help mitigate distortive market behavior during the transition period.

For newly built homes where ownership and possession transfer before April 1, 2013, purchasers will continue to pay the 7% provincial portion of the HST. However, to help offset the HST, the government has announced an increase in the BC HST New Housing Rebate threshold to $850,000 from $525,000 for new housing used as a primary residence where the HST is payable between April 1, 2012 and April 1, 2013, raising the maximum rebate available in respect of the provincial component of the HST to $42,500 from $26,250. Other incentives announced by the government are: (1) the BC First-Time New Home Buyers'

Bonus, a refundable income tax credit (up to a maximum of $10,000) available until PST is re-implemented for qualified first-time homebuyers who purchase newly constructed homes; and (2) a grant of up to $42,500 for the provincial component of the HST available to qualified buyers of newly-constructed secondary homes outside the GVRD and the CRD, between April 1, 2012 and April 1, 2013.

For newly built homes where construction begins before April 1, 2013, but ownership and possession transfer on or after April 1, 2013 (but before April 1, 2015), the BC portion of the HST will not apply. Instead, purchasers will pay a temporary, transitional provincial tax of 2% on the full house price, which according to government publications is equivalent to the average amount of embedded sales tax in newly built homes under PST.

For newly built homes where construction begins on or after April 1, 2013, the BC portion of the HST will not apply. Builders will once again pay 7% PST on their building materials, and on average according to government publications, about 2% of the home's final price will again be embedded PST.

CASE LAW UPDATE

1. Woo v. ONNI Ioco Road Five Development Limited Partnership, 2012 BCSC 764

The May, 2012 decision of the BC Supreme Court in Woo v. ONNI Ioco Road Five Development Limited Partnership is significant and has caused more than a little consternation in the development community. In that case, the Court ordered the developer to return the purchase price paid by five strata lot owners more than three years after their purchases completed, because the developer failed to deliver an amendment to disclosure statement to them.

The background facts are that the purchasers entered into contracts for the purchase of five strata units in 2006 and early 2007, and received a copy of the original disclosure statement at that time. Before the sales completed, the developer filed an amendment to disclosure statement with the Superintendent of Real Estate, which included notifications of subdivision and development approval, building permits, and the estimated date of substantial completion of the development. However, the amendment was never delivered to the plaintiff purchasers.

The purchasers completed their contracts and took possession in December, 2008. They only became aware of the amendment many months later in September, 2009. In April, 2010, the purchasers delivered notices of rescission to the developer and eventually applied to the Court for a declaration that they were entitled to rescind their purchase contracts pursuant to section 21(3) of the BC Real Estate Development Marketing Act (REDMA), which states that a purchaser may rescind a purchase contract at any time, regardless of whether

title in the unit has been transferred to the purchaser, if the purchaser was entitled to receive a disclosure statement (which includes any amendment thereto) from the developer but did not receive it.

The developer argued that the statutory right to rescind under REDMA could only be exercised before the purchasers completed their contracts. They also counterclaimed for occupational rent from the purchasers for the time they were in possession, should rescission be granted.

The Court held that the purchasers were entitled to rescind their purchase contracts and to the return of the purchase monies paid in exchange for re-conveying their units to the developer, and were not required to pay occupational rent. The Court stated that REDMA is consumer protection legislation and as such is to be interpreted generously in favour of the purchaser, consistent with a central objective of REDMA being to ensure that material facts are provided to purchasers when developments are being marketed to them. The amendment to disclosure statement contained material information and was a "disclosure statement" for the purposes of the Act, and accordingly the developer was required to deliver a copy to the purchasers which it failed to do. On the clear wording of the Act, the purchasers had the right to rescind their contracts at any time, regardless of whether title had transferred.

In denying the developer occupational rent, the Court stated that rescission under REDMA is a statutory remedy available to purchasers where a developer fails to perform its obligations under the Act, and not an equitable remedy where the concept of restitution or restoring the parties to their original position would apply. If achieving equity between the parties was the legislature's intention, then it would have included provision for an accounting or payment of occupational rent in the legislation.

A notice of appeal of this decision was filed by the developer on June 11, 2012.

2. Kalsi v. Achary, 2012 BCSC 361

Registered mortgages in BC must contain either the express mortgage terms between the borrower and lender attached to the document, or the document must contain reference to filed standard mortgage terms or the prescribed standard mortgage terms (the "Prescribed Terms") set out pursuant to the Land Title Act.

The Prescribed Terms include a definition of "covenantor" as a person who signs the mortgage as a covenantor, and set out the promises and agreements of the covenantor should a person sign the mortgage as covenantor. However, the Prescribed Terms do not contain guarantor provisions. Consequently, if a person signs a mortgage incorporating the Prescribed Terms as a guarantor, it is necessary to amend the Prescribed Terms in the mortgage document to specifically incorporate guarantor provisions, assuming no separate guarantee document is obtained.

This may seem obvious, but in the recent decision of the BC Supreme Court in Kalsi v. Achary, the lender discovered that the guarantees which it thought it obtained by the defendants signing the mortgage as guarantors were not enforceable.

In the Kalsi case, there were two guarantors of the borrower's loan obligations who executed the mortgage as "Guarantor" (i.e. they signed the Form B of the mortgage and the word "Guarantor" was typed below their signatures). However, the Prescribed Terms were not amended to add guarantor provisions, and no separate guarantees were signed.

The guarantors argued that although they intended to give a guarantee and signed the mortgage as such, no terms for the guarantee were agreed to and therefore there was no enforceable obligation. The lender's position was that despite the word "Guarantor" typed below the defendants' signatures on the mortgage, the effect of their signatures was that they signed as covenantors, and that this was so because the mortgage terms only contained provisions for covenantors, and not guarantors.

The Court rejected the lender's argument, noting that the Prescribed Terms could have been amended to include guarantor provisions and that there is a fundamental difference between being a covenantor and being a guarantor. A guarantor's liability is secondary to that of the party whose obligation he is guaranteeing, while a covenantor's liability is a primary obligation to pay the loan. The fact that in many circumstances there may be no practical difference between the two does not diminish the need to clearly spell out the obligation in an agreement. The Court dismissed the lender's action.

A notice of appeal of this decision was filed by the lender on April 11, 2012.