TALES FROM THE TRENCHES™
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SUBDIVISION NIGHTMARE!

Across Canada, there is an ongoing discussion about the lack of affordable housing. In some areas, developers won't build rentals because building condos is more lucrative, because there are rent controls, or perhaps a combination of both situations. Some Canadians are completely priced out of the housing market—especially in the Great Toronto Area and the Lower Mainland of British Columbia. Even in Alberta, where I live and work as a real estate lawyer, affordable housing is an issue.

A big part of the ongoing housing discussion is often around the never-ending growth of suburbs. Continual growth of mostly single-family housing chews up vast amounts of land, often prime, irreplaceable farmland. Huge pressure is placed on municipal resources. Servicing the new subdivisions costs more and more as suburbs expand. Developers pass on costs to homebuyers, which increases the cost of housing. This is an ongoing problem in many municipalities across Canada where there is room to expand.

Many municipalities, supported by provincial governments, believe that part of the answer is to allow increased inner-city density. If there are more and better housing choices available downtown and in the near suburbs, the theory is that suburban sprawl will be contained or at least slowed down. As part of the plan to increase density, some municipalities are allowing large lots to be subdivided. For example, a 50-foot lot could be split into two 25-foot lots. Upon subdivision, the existing house would be demolished and two new homes built. The existing property would then hold two homes rather than one, thus doubling the density. Whether or not this increases the stock of affordable housing is an arguable point, but that's a discussion for another day. Very quickly, the homes built on the 25-foot lots came to be known as 'skinnies.'

Recently, I had a client who purchased a home on a 50-foot lot, financing the purchase with Bank A. The plan was to subdivide the lot and build two skinnies. He found a builder, worked out his costs, and decided that he could make some money if he subdivided and built two new houses. The next step was to get financing for the two new builds, and off he went to Bank B. They loved the idea and fairly quickly approved him for two new first-mortgages. Happy guy that he was, our client told his surveyor to go ahead with the subdivision. Next, he obtained a demolition permit from the City of Edmonton and knocked down the existing house.

At this point our law firm, RMLO Law LLP, enters the picture. We get two sets of first mortgage instructions from Bank B, call our client, figure out what's going on, and get two new files open. The subdivision had been completed, so there were two new lots and therefore two new titles. As we always do, we get copies of those titles and immediately noted that the same mortgage to Bank A was on each of the them. Why?

When you subdivide a property, unless you deal with the existing lender, the existing mortgage that was on one lot now appears on both new lots. Let's say the existing property had been a really big 75-foot lot that ended up divided into three 25-foot lots. That same original mortgage on the one un-subdivided lot would now appear on the three new titles.

Let's go back to an earlier part of this Tale. You will recall that Bank B sent us two new sets of mortgage instructions with a key requirement. Bank B wants to be first on title. They want their mortgage, their financial charge to be first in priority. But, they can't be first in priority because Bank A is already on both titles.

As soon as we discovered the titles, I immediately call our client to ask, "Did you talk to Bank A about getting rid of their first mortgage?" "No," he says, "I thought that once the two houses were built, I would use the profit to pay off the old mortgage." He was already negotiating with two new buyers and, indeed, the draft contracts showed that the purchase price the new buyers were paying would generate sufficient funds to pay off that old mortgage.

Bank B had offered what are known as 'draw' mortgages, meaning they would advance funds to our client at various stages of construction with a final draw on completion. The difficulty is that Bank B wouldn't advance any funds unless they were first on title. They wanted first mortgages on both lots.

Off our client goes to talk to Bank A. You can imagine how this went: "What do you mean you demolished our security?" "Why didn't you come to us for your new financing?" "No, we won't discharge or postpone our first mortgage." Bank A was royally upset. They were not in any mood to make life easy for our client.

Our client was left with a huge financing problem because he could not get a draw on his new mortgages without the old mortgage disappearing. Luckily, we were able to help him find a workaround.

The solution, after much stress and lost sleep, was to convert one of the two new mortgages from a draw mortgage into a completion mortgage. His builder agreed to build first and be paid when construction was completed. Only one new sale contract was firm, so we started with that one. Once that first new home was built and sold, our client was short $200,000 to pay out the old mortgage after paying the builder. He begged and borrowed to come up with the money, incurring heavy financing costs and using up much goodwill with friends and family. Now he is fine to build the second home because the old first mortgage has disappeared from both new lots.

Lessons Learned:

1. If you subdivide a property with an existing mortgage, the full amount of the existing mortgage will appear on the title of all new subdivided lots.

2. If you need new financing to build on the new lots, check with your existing lender first.

3. Carefully work through what it will take to get rid of old financing. It's tricky, with lots of steps.

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