

Foreclosure proceedings and available remedies for mortgage holders and other creditors

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In the context of Canadian foreclosure proceedings, the remedies available to a creditor include a judicial listing order and a foreclosure order. In this article, we will discuss the contents and purpose of judicial listing orders and foreclosure orders, the differences between the two orders and when one is used in favour of the other. Lastly, we will address what happens in the event where there is a commercial tenant or tenants with outstanding lease payments.

In Alberta, the procedure for foreclosure is regulated by Rules 9.30-9.36 of the *Alberta Rules of Court*, 2010, Alta Reg 124/2010, as well as sections 37-50.1 of the *Law of Property Act*, RSA 2000, c L-7.

Foreclosure actions

A foreclosure occurs when a mortgagor (i.e., the borrower) defaults on their mortgage. Foreclosure is the process which vests the property with the mortgagee (i.e., the lender), and the borrower's right to redemption is extinguished¹.

What is a judicial listing order?

A judicial listing order, also known as judicial sale, is a potential remedy from a foreclosure action² where the Court will supervise the sale of property to allow the lender to transfer the mortgaged property to a third-party purchaser regardless of the borrower's objections³. Judicial listing is one of the primary remedies used in foreclosure actions in Alberta, British Columbia, Manitoba, Nova Scotia and Saskatchewan⁴. Judicial listing can also be used in other provinces except New Brunswick; however, it is not the primary remedy for default. In Ontario, P.E.I., Newfoundland and New Brunswick, a power of sale is the primary remedy for lenders in the event of a default⁵. Power of sale is also a sale of the mortgaged property by the lender to a third-party purchaser, however, it is done without court intervention. As such, the right to conduct a power of sale can be derived from either the provisions of the mortgage document itself or applicable provincial legislation⁶.

What is a foreclosure order?

A foreclosure order is an order that the lender obtains from the Court which transfers the title of the mortgaged property to the lender, who then takes possession of the property⁷. The lender can then sell the property without regard to the borrower's rights or the rights of "any subsequent lender or lower ranking-security holders"⁸.

When to use a judicial listing order versus a foreclosure order

Foreclosure orders and judicial listing orders are very similar in the sense that they both involve Court supervised processes. However, the difference between a foreclosure order and a judicial sale is that, for the former, the title to the mortgaged property is transferred to the lender and the sale constitutes full satisfaction of the debt⁹. A judicial listing order does not automatically provide full satisfaction of the debt and, if the proceeds resulting from the sale of the property are insufficient to satisfy the debt, the lender can sue the borrower for the deficiency¹⁰. However, if the proceeds from the sale exceed the balance of the mortgage, the excess must be paid to the borrower or any other creditor with a valid claim¹¹.

Judicial listing orders are commonly used where the property is of high value, difficult to appraise or in cases where it is accepted that the appraised value of the property is greater than the value of the debt¹². The Court does not owe a duty to the third-party purchaser but has a duty to the borrower and the lender to optimize the benefits of sale¹³. Therefore, the Court will likely deny a judicial sale if the borrower's indebtedness to the lender exceeds the value of the mortgaged lands¹⁴.

Foreclosure is commonly used where the value of the debt is greater than the appraised value of the property¹⁵. In depressed real estate markets, a foreclosure is more favourable for lenders as they may take possession of the property and wait until the market value of the property increases.

However, where the value of the property is significant, it may be strategically advantageous for the lender to apply for a foreclosure order. The lender can then sell the property for a greater value than that of the debt, and they are entitled to retain the surplus value realized¹⁶.

However, it is worthwhile to note that, generally, "[w]here there is equity in the property, there is a 'bias' towards a judicial sale that will generate proceeds for subsequent encumbrancers; foreclosure is treated as the remedy of last resort: *Law of Property Acts*. 40(2)(a); *Montreal Trust Co. of Canada v Olympia & York Developments (Administrator of)* (1998), 66 OTC 45 at paragraphs 16-21, 19 RPR (3d) 111"¹⁷.

Tax implications

There are also different tax implications between a judicial sale and foreclosure order. Since the lender does not obtain legal or beneficial ownership in a judicial listing, section 181.3(1)(a) of the *Income Tax Act*¹⁸ does not apply¹⁹. Conversely, under an order of foreclosure, the lender acquires beneficial title to the mortgaged property, and the lender can be treated as having acquired an asset for the purpose of section 181.3(1)(a) of the *Income Tax Act*²⁰.

Overview of the foreclosure action

1. Issuing a statement of claim

When a borrower defaults on a loan payment, the lender may file a Statement of Claim at the Court of King's Bench. The lender must then serve a copy of the statement of claim on the borrower.

2. Borrower responds to the statement of claim

The period the borrower has to respond to the statement of claim will depend on where they are served. For the purposes of an action commenced in Alberta, if the borrower is served:

- in Alberta, the borrower will have twenty days to respond;
- outside of Alberta, but within Canada, the borrower will have one month to respond; and
- outside of Canada, the borrower will have two months to respond²¹.

The borrower can file either a statement of defence, which denies that a default has occurred, or a demand for notice, which does not dispute that there has been a default, but the borrower wishes to receive updates with the regards to the process²².

If the borrower does not respond within the prescribed period, the lender will notify the Court that the borrower is in default and is not defending the claim.

3. Lender files affidavit of value and affidavit of default

Prior to filing an affidavit of value, an independent appraisal of the value of the property must be ordered. The appraisal will include both the current fair market value and forced sale for cash value of the property²³.

The lender will then file both an affidavit of value and an affidavit of default. The former will detail the value of the property, as determined by a certified property appraiser. The latter contains details regarding when the mortgage was advanced, when the default of the mortgage occurred and the balance owing²⁴.

4. Order nisi

Following the submissions of the affidavits, the Court will then determine whether the mortgage is in default. In the affirmative, an *order nisi* will be issued²⁵. The *order nisi* will detail the balance owing, the period of time the borrower has to pay (the Redemption Period), and if the borrower fails to pay, they will not be able to redeem the mortgage²⁶. The Court can issue either an *order nisi* for sale or an *order nisi* for foreclosure following the expiry of the Redemption Period.

Pursuant to the *Law of Property Act*, the Redemption Period is generally six months from the date of the granting of the order²⁷. However, the Redemption Period may be reduced or extended by the Court with regards to the following factors:

- the ability of the debtor to pay;
- the value of the land including the improvements made on it;
- whether the land has been abandoned;
- the nature, extent and value of the security held by the creditor; and
- whether the debtor's failure to pay was due to temporary or permanent unemployment or other conditions beyond the control of the debtor²⁸.

4.A Judicial Listing Order

The general process for judicial listing is very similar to foreclosure. Instead of an order of foreclosure, the lender would apply for a listing order from the Court. The listing order will include a listing agreement with a licensed real estate agent realtor selected at the sole discretion of the plaintiff.

4.A.i Property is listed for sale

As stated above, the property will be listed for sale following the expiry of the Redemption Period. The terms of the purchase will be prescribed by the Court. Usually, the real estate purchase contract will state that the property is sold on an "as is" basis with no warranty²⁹.

4.A.ii No adequate offers

If there are no adequate offers for the listing, the Court has jurisdiction to either order for foreclosure of the property or relist the property for sale pursuant to section 40(2)(b) of the *Law of Property Act*³⁰. It is common for the relisted price to be lower than the initial listing price to help facilitate sale of the property³¹.

4.B Foreclosure Order

As mentioned above, the foreclosure order is viewed “as the remedy of last resort”³². As such, the Court will typically issue an *order nisi* for sale³³. However, where a foreclosure order is issued, the *order nisi* for foreclosure constitutes a judgment of the Court, but it does not take effect until the order is made absolute³⁴. Therefore, the order absolute is an accessory to an *order nisi* for foreclosure.

4.B.i Order absolute

Order absolute, also known as a final order, is granted by the court once the Redemption Period expires. Where the foreclosure order is made absolute, the title of the property will be transferred in the name of the lender free from all right and equity of redemption, and the latter is entitled to receive a certificate of title for the property³⁵. Consequently, the lender becomes the owner and can freely transact with the property.

Money holding

Judicial listing or foreclosure order in commercial real estate

It is not uncommon for a judicial listing to be ordered in cases with commercial tenants³⁶.

Existing leases

Judicial listing

Since the general principle is that the property is being sold on an “as-is” basis, all leases and contracts that are assignable shall be assigned to the purchaser as of the closing date and the purchaser shall assume all obligations thereunder³⁷. The purchaser has the responsibilities to perform their own due diligence and the Court can provide guidance such as providing document (including all leases and contracts, billing statements sent to tenants, etc.) to help the purchaser conduct searches and enquiries deemed necessary or advisable to the sale of the property³⁸.

In practice, if the value of the loan is largely dependent on the rental income of the property, the lender will want to preserve the leases and enter into agreements with the tenants of the real property³⁹. This can be done using a subordination, non-disturbance and attornment agreement⁴⁰.

Foreclosure

Where a foreclosure order is granted by the Court, the effect is to transfer the title of the property to the lender “free from all right and equity of redemption on the part of the owner, mortgagor or encumbrancer or any person claiming through or under the owner, mortgagor or encumbrancer subsequent to the mortgage or encumbrance ...”⁴¹. As such, where a lender takes the title of the property by foreclosure, the former is not bound by an existing lease or existing leases on the property⁴². However, such is the case only where the lease exceeds three years and is registered subsequent to the mortgage⁴³.

On the other hand, a lender can “except certain interests from the foreclosure order, [...] by making [the foreclosure order] expressly subject to those interests”⁴⁴. However, a foreclosure order which states that the lender is bound by the lease does not in itself make the lease enforceable against the tenant⁴⁵. A tenant could refuse to pay rent and, consequently, no landlord/tenant relationship is established. In order for the lease to be enforceable between the lender and the tenant, the two must enter into a landlord/tenant relationship through privity of contract prior to the foreclosure⁴⁶. Notably, the assignment of rents does not create privity of contract between the lender and the tenant⁴⁷.

Assignment of rents and leases

If the mortgaged property is a commercial property, typically a lender will want to maintain the tenants for rent payments. The lender on a commercial property will usually have additional security, such as a general assignment of rents⁴⁸. If the lender chooses to exercise this option, the solicitors of the lender should not hold or retain the money.

The money should be remitted to the lender and credited to the mortgage account⁴⁹.

In the case of a foreclosure order, pursuant to the assignment of rent and leases, the rental payments should be paid either directly to the lender or to the lender's receiver⁵⁰.

Priority payables

Generally, the priority of interests will be governed by the order of registration if registration is required⁵¹. However, there are some unregistered interests that will have automatic priority over a mortgage, regardless of when they are created⁵². For example, any liens that are created by statute or operation of law will have priority to any encumbrances on the property⁵³. Some examples of these priority liens include unpaid real property taxes, municipal taxes and environmental charges⁵⁴.

Environmental remediation obligations may take priority over creditors, including secured creditors⁵⁵. As such, environmental obligations may take precedence over lenders. Moreover, the party advancing the environmental claim does not need to be a regulator for their claim to rank in priority to lenders⁵⁶. It has also been noted in caselaw that "abandonment and reclamation obligations [...] rank in priority to claims of municipalities for unpaid property taxes in insolvency proceedings"⁵⁷.

Additionally, in the case of judicial listing orders, if a Minister registers a writ against the title for unpaid taxes, the Minister will take priority to the remaining funds from a judicial sale⁵⁸. Goods and Services Tax (GST) is also payable on the purchase price as required by the *Excise Tax Act*⁵⁹. Typically, the third-party purchaser is liable for any GST that is payable in respect of the transaction⁶⁰. This can be a term within the property purchase agreement as suggested by the sample judicial listing document provided by the Alberta Court.

Although there are some unregistered interests that will take priority over a mortgage, there is a lack of clarity in the applicable case law about which unregistered interest has higher priority. It is also unclear which party has the obligation to pay for these interests that takes priority over a mortgage.

Personal property

Pursuant to rule 9.27 of the *Alberta Rules of Court*, a lender who enforces a judgment or order from the Court does not need to remove personal property from the premises⁶¹. Where an order for judicial sale or an order for foreclosure has been granted by a Court, if the borrower has left personal property on the land or at the premises after having vacated the land or premises pursuant to the order, the lender can dispose of the abandoned goods if the value of said goods does not exceed \$2,000⁶². A lender may sell personal property that exceeds the value of \$2,000 in particular circumstances⁶³. However, generally where the value of the personal property exceeds \$2,000, the lender must store or arrange for the storage of the personal property for one month following the date at which the personal property was abandoned⁶⁴. After the expiry of the one-month period, the lender may dispose of the goods either by public auction or by private sale, subject to the approval of the Court⁶⁵. If the abandoned goods are sold through public auction or private sale, the proceeds of the sale will be distributed in the following order:

1. To pay the cost of the sale.
2. To pay for storage, transportation and other moving expenses associated with the sold goods.
3. To pay the balance to the owner of the personal property⁶⁶.

If no bid is received for the abandoned goods at the public auction, the lender may dispose the abandoned goods⁶⁷.

Judicial listing

Generally, all fixtures and chattels will be sold on an “as-is” basis during a judicial listing. The real estate purchase contract provided by the Court can set out specific terms regarding ownership of unattached goods on the premise. In the sample judicial listing document provided by the Alberta Court, the seller is not liable for the removal of any chattels found on the property prior to closing and on closing, the buyer may have possession of all the fixtures and chattels on or about the property on an “as-is” basis⁶⁸.

Foreclosure order

As a foreclosure order is a judgment granted by the Court, the *Alberta Rules of Court* rules 9.27 and 9.28 apply. As such, where personal property is left on the land or premises that was transferred to the lender, rules 9.27 and 9.28 govern what is to be done with the personal property⁶⁹.

FOOTNOTES

To discuss these issues, please contact the author(s).

This publication is a general discussion of certain legal and related developments and should not be relied upon as legal advice. If you require legal advice, we would be pleased to discuss the issues in this publication with you, in the context of your particular circumstances.

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