OSLER

What you need to know about the assumption of commercial mortgage loans

JULY 20, 2023 6 MIN READ

Authors: Paul S. Taylor, Patrick Mah

Ever since the Bank of Canada's Overnight Interest Rate and Lenders' prime interest rates (collectively, the Interest Rates) started to increase in March of 2022, there has been a significant increase in the number of commercial mortgage loan assumption transactions (Assumption Transactions) being completed across the country. Our Financial Services Group has completed more Assumption Transactions in the past 12 months than we have in the previous 10 years. Lenders who have never completed Assumption Transactions are finding that they are completing them for the first time at the request of their borrowers.

The driver for the increase in the number of Assumption Transactions is rapidly increasing Interest Rates and the desire for borrowers to take advantage of a lower existing interest rate. For existing borrowers, this means using attractive financing terms to entice a purchaser to buy their property or to increase the purchase price for their property. For new borrowers, this means saving the interest rate differential between currently available interest rates and the existing borrower's lower fixed interest rate.

In this article, we discuss Assumption Transactions generally and explain what they are; highlight some of the benefits of Assumption Transactions for borrowers and lenders; discuss how Assumption Transactions are approached from a legal perspective; and highlight some common pitfalls and nuances for lenders to be aware of with respect to Assumption Transactions.

Assumption Transactions

An Assumption Transaction is a financing transaction in which, at the time of the completion of purchase and sale of a commercial property, the purchaser assumes the vendor's mortgage loan and related loan security. Upon completion of the purchase and sale transaction and the Assumption Transaction, the purchaser steps into the vendor's shoes, replacing it as the lender's borrower and assuming its obligations as borrower with respect to the mortgage loan and loan security and becomes liable to the lender.

Benefits of Assumption Transactions for borrowers and lenders

Borrowers and lenders can benefit from completing an Assumption Transaction in a number of ways, including those set out below.

Benefits for existing borrowers:

- avoidance of prepayment fees
- a potentially higher purchase price on the commercial property being sold
- an increased likelihood of completion of the purchase and sale transaction

Benefits for new borrowers:

- interest savings over the term of the mortgage loan
- benefiting from a previously paid mortgage loan insurance premium, without having to repay one
- potential savings on legal fees, the cost of title insurance and land titles registration fees
- a more efficient and quicker legal process

Benefits for lenders:

- building goodwill and strengthening relationships with both existing and new borrowers, thereby facilitating increased future business
- building new relationships with new borrowers that the lender hasn't historically dealt with
- savings with respect to time, money and effort that they would otherwise spend if a mortgage loan were to be paid out (as opposed to assumed)
- an improved security position with reduced risk profile
- a quicker, less onerous approval process compared to a new loan application
- increased fees with respect to amendments and the application for consent to the Assumption Transaction

Legal considerations for Assumption Transactions

If a lender is willing to consent to an Assumption Transaction, the lender typically issues a consent letter, setting out the terms and conditions upon which it is willing to permit an Assumption Transaction to be completed (a Consent Letter). The Consent Letter will also typically include any amendments required to the loan agreement and related loan security and provide for any new terms and conditions and security requirements.

When all parties sign off on the Consent Letter, the lender will instruct its solicitor to complete the legal work and prepare the legal documentation in relation to the Assumption Transaction, which typically includes the following:

- reviewing the underlying security and identifying required amendments
- completing the necessary legal due diligence on the loan parties, along with high-level due diligence on the commercial property
- preparing the assumption agreement and other loan security documents
- providing advice with respect to whether or not title insurance is required and whether the assumption agreement needs to be registered on title to the commercial property
- registering new or amended personal property registrations against the new loan parties granting security interests, as applicable
- working with the solicitors for the existing and new borrowers to determine appropriate trust conditions and closing mechanics for completion of the Assumption Transaction

Pitfalls and nuances for lenders

While Assumption Transactions may be fairly common and are beneficial to lenders, lenders should be cognizant of the following pitfalls/nuances with respect to Assumption Transactions:

- Be cautious not to release loan parties from obligations that would otherwise survive the payout of the mortgage loan (for example, environmental covenants and indemnities).
- Ensure the payment of interest up to and following the completion of the Assumption Transaction is accounted for (preferably by an adjustment between the existing and new borrower).
- Do not inadvertently diminish loan security through poorly papering the Assumption Transaction.
- Be careful not to provide personal rights inadvertently to new loan parties that were only intended to be provided to the existing loan parties.
- Do not confuse and overlap primary and secondary liability of the loan parties. Address this through the security requirements.
- Assumption Transactions with individuals need to be approached differently than Assumption Transactions with corporations given the differences with respect to available recourse.
- Consider whether title insurance is required notwithstanding that the loan security already exists.
- Be alive to any required third-party approvals (for example, Canada Mortgage Housing Corporation approval with respect to an insured loan) in connection with the Assumption Transaction and get ahead of them, so that there is no adverse impact to the timeline for closing the Assumption Transaction.
- Do not skip due diligence and assume that it can be glossed over because the loan is an existing loan. Ensure due diligence is still completed to some degree on the existing loan parties, the commercial property and any new loan parties.
- Consider whether there will be a change in relation to the property manager and review any new related property management agreement, if any prior to completion of the Assumption Transaction.
- Ensure that Know Your Client (KYC) and anti-money laundering (AML) legislation is complied with in relation to the new loan parties and not overlooked.
- Treat each Assumption Transaction as a unique transaction. While there are similarities with respect to each Assumption Transaction, there are differences, and the terms and conditions need to be tailored to each Assumption Transaction.

If you have any questions in relation to Assumption Transactions or any other financing matters, please do not hesitate to reach out to the Osler FS team. We have experts across the country that would be happy to assist you and answer any questions you may have.

<!–

OSLER

Key contacts for assumptions of commercial mortgage loans

Rick Fullerton Partner, Financial Services, Toronto rfullerton@osler.com 416.862.4604

Constantine Troulis Partner, Financial Services, Montréal ssarangi@osler.com 514.904.8105

Patrick Mah Partner, Financial Services, Calgary pmah@osler.com 403.260.7052

Paul S. Taylor Partner, Financial Services, Calgary ptaylor@osler.com 403.260.7085

Martha Martindale Partner, Financial Services, Calgary mmartindale@osler.com 604.692.2759

–>