

**Buying Free of Lien Claims —
The Home Buyer Provisions of the *Construction Lien Act*¹**

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I. — Introduction

While the introduction of the *Construction Lien Act, 1983*² made sweeping changes to the law of liens in Ontario and clarified many issues, some of the problems that had made the reforms necessary were not addressed. One of those problems was the unusual position of purchasers of new homes. The question whether such a purchaser was to be considered an “owner” for the purposes of the Act was a question that depended on the facts of each case. If the purchaser was an “owner”, holdback obligations would exist and turn the closing of the transaction into an ordeal. Was the buyer an “owner”? Did the buyer have to keep a “holdback”? How was a buyer to close?

Banks would not advance the funds without proof that all holdbacks had been properly retained. Purchasers were often not in a position to ensure that such was the case and would engage in costly litigation to compel vendors to prove that they had complied with the holdback provisions of the Act.³

The chairman of the Attorney General’s Advisory Committee on the Draft Construction Lien Act put the matter as follows:

Purchasers have considerable latitude in selecting components of the home. Nevertheless, the transfer of title and payment does not occur until closing. It seems to me, that as a practical matter, a purchaser waiting in the moving van with his three children and the dog are often not in a position to withhold the holdback from the builder. I tend to think that the best course would be to provide such purchasers are not owners within the meaning of the Act.⁴

The Attorney General responded to these concerns in an address to the Legislature:

Mr. Speaker, on January 25th, 1983, the House gave 2nd and 3rd Reading to Bill 216, the *Construction Lien Act, 1983*. The Act came into force on April

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²S.O. 1983, c. 6.

³See *Seltor Holdings Ltd. v. Kettles* (1983), 43 O.R. (2d) 659, 3 C.L.R. 259 (Ont. Div. Ct.)

⁴Cited in H. J. Kirsh, *Kirsh’s Guide to Construction Liens in Ontario*, 2nd edition (Toronto: Butterworths, 1995) at 10.

2nd. Some members of the Legislature and others have raised a problem that is causing hardship to new home purchasers. I have been asked to intervene to redress the problem. It is my intention to do so.

Many lenders were surprised by the speed with which the House, on a non-partisan basis, enacted the lien legislation and they appear to have been unprepared for it coming into force so quickly. As a result, some of the provisions of the Act have been interpreted in a manner not in accord with our intentions.

The problem raised by the Member for Oshawa relates particularly to subsection 80(5), dealing with the priority of liens over mortgages registered subsequent to the commencement of an improvement.

When a purchaser of a new home, who has not had the house built for him or her and, therefore, is not an "owner" under the Act, closes the transaction, advances the purchase price and receives a conveyance from the builder, it is clear that if no liens are registered at the time and the purchaser has no written notice of a lien, the interest of the purchaser has priority over any lien. That is the effect of subsection 80(6).

It has long been, and in my opinion, is now the law, that a mortgage arranged by a purchaser, who is not an owner, advanced and registered at closing also has priority over liens which have not been registered.

It was not our intention to confiscate part of the interest of mortgagees lending to purchasers. The lien is a right over the interest in the property of the person who had the improvement made.

While several highly regarded lawyers have given the same opinion as I have just expressed, doubt remains in the mind of some lenders. They have not been advancing 10 or more per cent of the price at closing. Some purchasers of new homes have been forced to arrange interim financing for a period of up to sixty days from closing. Not only could this be harmful to the individual purchaser, but it also could put a cloud over purchasing a home and might thereby harm the construction industry which is important to the economic health of the province.

I could refer the interpretation of the subsection to the courts and wait for clarification. However, that would not be the desire of the Government or of Members opposite.

While I had hoped to wait for at least a year before making amendments to the Act, I believe that there should be amendments in the near future to clarify the intention of the legislation.

The effect of the amendments that I will bring forward will be to make it clear that a mortgage of a purchaser's interest in a new home is not subject to the priorities of subsections 80(2) or of 80(5). These amendments will be retroactive to April 2nd when the Act came into force.

In addition, the conveyancing bar has requested that there be legislative clarification of when a purchaser's interest in a new home becomes an owner,

and thereby becomes responsible for holdback. The amendments will clarify this issue.⁵

And so they did. Section 1 of the *Construction Lien Amendment Act, 1983*⁶ introduced a definition of “home buyer” which has remained unchanged since. It provides as follows:

“home buyer” means a person who buys the interest of an owner in a premises that is a home, whether built or not at the time the agreement of purchase and sale in respect thereof is entered into, provided,

(a) not more than 30 per cent of the purchase price, excluding money held in trust under section 53 of the *Condominium Act*, is paid prior to the conveyance, and

(b) the home is not conveyed until it is ready for occupancy, evidenced in the case of a new home by the issuance of a municipal permit authorizing occupancy or the issuance under the *Ontario New Home Warranties Plan Act* of a certificate of completion and possession

At the same time, the definition of “owner” was amended to include the words “but does not include a home buyer”. Thus, home buyers as defined in the Act were no longer statutory owners under the Act.

II. — Case Law

In *Florida Drywall Co. v. Graham*,⁷ the defendants G entered into a purchase and sale agreement with the defendant T, pursuant to which T was to build a house for G. The purchase price for the land and completed house was \$245,000, and G paid \$5,000 to T upon execution of the agreement and an additional \$80,000 one month later. \$60,000 of the latter amount was a loan to the defendants L and T, secured by a promissory note. When the transaction closed, G paid the balance of \$265,000 plus \$20,000 for extras. G. took possession without a municipal occupancy permit or certificate of completion under the Ontario New Home Warranties Plan Act. The plaintiffs registered claims for lien and brought actions in support of their respective claims. The issue turned on whether the defendants G were home buyers or owners. The Court held that the payment of \$80,000 was a payment on account of the purchase price. The total sum paid prior to conveyance was \$85,000, which constituted 32% of the total purchase price. Consequently, the defendants G did not meet the requirements essential to the application of the “home buyer” definition and were not exempt

⁵Cited *ibid.*

⁶S.O. 1983, c. 77, s. 1.

⁷(1986), 20 C.L.R. 235 (Ont. H.C.).

from lien claims. Dunlap L.J.S.C. held that this result was compatible with the following policy statement of the Ministry of the Attorney General:

The definition of “home buyer” is intended to encompass purchasers whose intention is to buy a home and not to have one built. The total deposits a “home buyer” may make is limited to 20 per cent [later amended to 30%]. This is a somewhat arbitrary figure, but reflects the fact that, where deposits are greater than this amount, the purchaser is financing construction. It also is designed to protect suppliers of services and materials by ensuring that there is a significant amount at stake at closing to deal with liens that are registered. The definition requires the conveyance of both the land and home only after the home is ready for occupancy. This will prevent avoidance of the Act and permit those working on the home site to know when they may lose their lien rights. Those who have left the site will be able to demand relevant information. [. . .] This will provide certainty to all parties to the conveyance.

The effect of [the home buyer provisions] on a builder is to provide a choice. A builder who obtains a significant part of the financing from a home purchaser before closing must realize that the person is an owner under the Act and holdback must be retained by that purchaser on closing. A builder who is financing construction on his own credit, and obtains a deposit of 20 per cent or less, will obtain the full balance of the purchase price on closing with the home buyer.⁸

In *L.D. Ducharme Systems Inc. v. Denamer Homes Inc.*,⁹ the purchasers entered into an agreement of purchase and sale with the builder to purchase a home to be constructed. The purchase price was \$265,000 and the purchasers paid a deposit of \$20,000. The transaction closed on December 31, 1990, and a Certificate of Completion and Possession under the *Ontario New Home Warranties Plan Act* was completed at that time. The date of possession was not inserted into the certificate, nor was the actual purchase price. At closing, the vendor’s solicitor undertook to discharge two liens that had been registered on title. He did so, and the liens were discharged in early 1991. However, subsequent to the registration of the transfer in favour of the purchasers, four liens were registered against the property. Two of these were subsequently discharged. The purchasers applied to vacate the remaining two liens, arguing that they were not “owners” for the purposes of the Act. The Court allowed the motion.

Justice Leitch held that:

The exclusion of “home buyer” from the definition of “owner” in s. 1(1) of the Construction Lien Act reflects the fact that a purchaser who pays less than 30 percent of the purchase price prior to closing is clearly not financing

⁸Cited in an annotation to the decision by R.C. Harason (1986), 20 C.L.R. 235 (Ont. H.C.) at 236.

⁹(1994), 17 C.L.R. (2d) 107 (Ont. Gen. Div.).

the construction of the home. In essence therefore, those who supply services or materials to the building are forced to look to the vendor for payment and cannot create lien rights in the property. A "home buyer" is not a person whose interests can be the subject of a lien. The answer to the question whether or not a "home buyer" has an interest in which a lien can be created, cannot in my view be different when the "home buyer" acquires title after a lien is registered.

The plaintiffs' submission that a "home buyer" has a responsibility to protect himself if a lien is registered before his conveyance is registered does not reflect what I see is the reality of the "home buyer" exemption to s. 14(1). That is, that it is the vendor/builder and not the "home buyer" who is financing the construction.

Kevin P. McGuinness, secretary to the Attorney General's Advisory Committee on the Draft Construction Lien Act, had little good to say about this decision:

The orthodoxy of this decision is very doubtful. If it stands for the proposition that a home buyer may complete the purchase of a home without regard to the fact that liens are registered against title to the premises on which the home sits, then the decision is manifestly wrong. There is not one iota of support in the legislation for such an interpretation, and the general provision granting set down in section 78(1) granting priority to the lien claimants would be sufficient answer against it. If the decision stands for the narrower proposition that a special rule of priority applies to home buyers, the decision is equally incorrect. Leitch J. erroneously confuses the question of whether or not home buyers are owners (by express provision of the statute, there are not), with the entirely separate question of whether their interest is prior or subordinate to the rights of the lien claimants in respect of the premises. There is nothing in the home buyer or priority provisions of the Act to suggest that home buyers are subject to any special rules as to priority. On the contrary, the very clear wording of section 78 is that they (like all other persons acquiring the interest of an owner by way of conveyance) are subject to exactly the same rule under section 78(4) of the Act as are mortgagees.

[. . .]

About the only thing that one can say in favour of the decision in *L.D. Ducharme Systems Inc. v. Denamer Homes Inc.* is that it may protect lawyers who act for purchasers from negligence claims, where they proceed to close a sale in the face of a registered claim for lien. If the court had decided the case correctly, the completion of a purchase in the face of preserved lien claims could possibly have exposed the purchaser's lawyer to a possible claim in negligence. Be that as it may, the legislation has quite clearly stated that the suppliers to an improvement are entitled to a lien against the premises that they improve. Nothing in the Act allows a purchaser's solicitor to disregard the existence of a preserved lien upon receiving an undertaking from a vendor's solicitor at the time of closing a conveyance to discharge existing lien claims. Nothing could be clearer in the legislation than that the owner's freedom to deal with the property was to terminate once it became evident through the preservation of a lien or the giving of written notice of a

lien that a breakdown in payment had occurred, until such time as steps were taken to provide for the liens (whether or not registered) under Section 44 of the Act. And nothing in the home buyer provisions of the Act even incidentally relates to the question of priority. As noted repeatedly in this chapter: the question of ownership and the priority of competing interests in the premises are entirely different.

In *Ottawa Air Design Ltd. v. Zietak*,¹⁰ purchasers were found to be home buyers even though they did not sign the certificate of completion and possession until long after the deed was registered. The new home in question was ready for occupancy when conveyed and the date of the issuance of *Ontario New Home Warranties Plan Act* certificate was held to be the date when it was signed by the vendor, particularly where the purchaser closed the transaction on that date. That being the case, there was no obligation on the purchasers to retain any holdback for liens that they were not aware of when the transaction closed.

In *595997 Ontario Inc. v. MacDonald Homes Inc. (Trustee of)*,¹¹ a landscape contractor registered a general lien for the full amount of its claim on each of several lots in a townhouse development, even though the contract provided that liens would arise and expire on a lot-by-lot basis and would be apportioned to reflect the actual services and materials provided to each lot. The landscape contractor brought an action against the developer and the purchasers of one of the townhouses. The purchasers paid the full amount of the general lien into trust and successfully moved to dismiss the lien action against them by obtaining a declaration that they were “home buyers” under the *Construction Lien Act*. The trust funds were paid out to them. The orders were upheld on appeal.

The most recent decision on the issue of “home buyers” is the decision by Master Saunders in *Kostolnik v. Vanbots Construction Corp.*¹² At the heart of this dispute was a contest between the developer and the general contractor over delays and deficiency work. At a point prior to publication of a Certificate of Substantial Performance, but after an occupancy permit had issued, the developer vacated two small suppliers’ liens and closed approximately 100 unit sales. The general contractor was notified of the closings. Nevertheless, the general contractor and a host of subtrades liened all of the units, including those of the eight applicants in *Kostolnik*. The purchasers of these units moved to discharge the various liens, arguing that they were “home buyers” under the Act and since the definition of an “owner” expressly excluded home buyers, no liens could attach to their interests. The lien claimants argued the reverse, that the purchas-

¹⁰(1996), 28 C.L.R. (2d) 106 (Ont. Gen. Div.).

¹¹(1997), 36 C.L.R. (2d) 61 (Ont. Div. Ct.).

¹²(2000), 6 C.L.R. (3d) 151 (Ont. Master)

ers were not “home buyers”, but “owners”. This placed the elements of the following statutory definition of “homebuyer” in issue:

“home buyer” means a person who buys the interest of an owner in a premises that is a home, whether built or not at the time the agreement of purchase and sale in respect thereof is entered into, provided,

(a) not more than 30 per cent of the purchase price, excluding money held in trust under section 53 of the *Condominium Act*, is paid prior to the conveyance, and

(b) the home is not conveyed until it is ready for occupancy, evidenced in the case of a new home by the issuance of a municipal permit authorizing occupancy or the issuance under the *Ontario New Home Warranties Plan Act* of a certificate of completion and possession

The lien claimants’ first argument was that the onus of proving that the homes were “ready for occupancy” was on the purchasers and that they had not met that onus. The purchasers argued that even if they had the onus, the onus was satisfied by producing the municipal permit authorizing occupancy as well as a certificate of completion and possession under the *Ontario New Home Warranties Act*. They argued that once they had made this proof, the onus shifted to the lien claimants to prove that despite the evidence of these two documents, the homes were, in fact, *not* ready for occupancy. The Master agreed that the permit and the certificate were sufficient to shift the onus to the lien claimants.

The lien claimants further argued that the units might not be “homes” for the purposes of the Act, a proposition which, in light of the definition of “home” in s. 1(1), could not be seriously considered.

On the main question, of whether the homes were ready for occupancy as a matter of fact, notwithstanding the permit and the certificate, the lien claimants had relied on deficiency lists:

There is filed by counsel for the lien claimants, in a brief called “Compendium of Documents of Vanbots Construction Corporation”, certificates under the Ontario New Home Warranty Programme for each of the 8 units. The difference between these certificates and those filed in the motion record #1, tab F is that attached to these certificates are deficiency lists, which are quite lengthy, (in one case there are four pages of notes). Many of these lists state that the appliances have not been installed. With these deficiency lists, the lien claimants are attempting to show that the condominiums were not ready for occupancy. However, also filed on the hearing of the motion were other deficiency lists for each of the 8 units. These lists show the deficiencies to be much fewer than that shown in the deficiency lists in the Compendium of Documents. These lists show that the condominiums seem to have been ready for occupancy, for the deficiencies set out therein were minor. These lists were revised on February 7, 2000, after the deficiency lists attached to the certificates in the “Compendium of Documents of Vanbots Constructions Corporation”.

The Master dismissed the lien claimants' argument. He found that there was nothing in the deficiency lists that indicated that the units were not ready for occupancy:

[The lien claimants' witness] also indicated that to obtain the certificate of occupancy the systems in the building must be in proper working order which would be the fire alarm system, the elevators, the sprinklers, the mechanical system including the air make-up units, the boilers, the fans, smoke and heat detectors, and the fire pump and standpipe. All these systems were working and therefore the certificate of occupancy was issued. I therefore find that the units were ready for occupancy and that the applicants herein are home buyers under the *Construction Lien Act* and are entitled to an order discharging the lien claimants herein and vacating the certificates of action.

This decision seems perfectly in tune with the intention of the drafters of the *Construction Lien Act*, and its hasty amendments, as discussed above. Home buyers are to be protected from liens after closing, and that is exactly what the Master did in the final result.

The decision has, however, received mixed reviews from at least one prominent member of the real estate bar. An article in *The Lawyers Weekly* points out that while the result in this decision was favourable to the purchasers, the *Kostolnik* decision may have created some uncertainty where none had previously existed:

No longer can buyers from builders take comfort in an occupancy permit and/or ONHWP certificate of completion or possession. [. . .] The case indicates that if there are substantial outstanding deficiencies on closing, "unregistered subsisting liens aren't extinguished, but can be validly registered on title following closing." As a result, it becomes "impossible to assure new home and condominium buyers that construction liens won't materialize after closing." This possibility raises a number of practice questions that real estate lawyers should consider, such as who assesses the deficiencies, and should the lawyer seek a holdback of funds before closing?¹³

In light of the fact that the *Construction Lien Act* expressly stipulates that "readiness for occupancy" is evidenced by the issuance of a municipal permit authorizing occupancy or the issuance of an ONHWP certificate, it would indeed be curious if courts were compelled to read their way through lengthy deficiency lists even where the statutorily required documents have been produced. It is to be hoped that *Kostolnik* will not be read to that effect.

¹³A. Silverstein, "Consumer Protection from Tradesmen's Liens Scaled Back", *The Lawyers Weekly*, vol. 20, no. 42 (March 16, 2001), pp. 9-10.