



## **RealTalk® about Real Estate**

Issue 2015-3

### **Topic: Who can rely on an appraisal?**

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The Alberta Court of Queen's Bench recently released a decision which involved considerations of reliance on what the lenders felt was a faulty appraisal. For those with the time and interest, the full decision is attached. For everyone else, here's our summary:

The original lender (Capital Direct Lending Corp.) ordered an appraisal through National Appraisal Service. The appraisal was completed by Howard & Company appraisers and the loan was advanced. However (and this is important), the loan was subsequently sold to Capital Direct Income Trust.

The appraisal specifically limited who could rely on it, namely the "client" at the time, which was Capital Direct Lending Corp.. However, since Capital Direct had subsequently sold the mortgage, it had been paid in full and therefore did not actually suffer the loss. The loss was suffered by the new mortgagee, Capital Direct Income Trust. So, in summary, the loss was suffered by someone who was not permitted to rely on the appraisal.

The Court found that this was sufficient on its own to dismiss the action against the appraiser.

Our take on this: The 'limitation of reliance' wording in an appraisal is powerful. If your lender relies on an appraisal, make sure that the wording of the appraisal actually permits that. If not, either get a new appraisal or get the permission of the appraiser for your lender to rely on it.

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# Court of Queen's Bench of Alberta

**Citation: Capital Direct Lending Corp v Howard & Company Real Estate Appraisers and Consultants Inc, 2015 ABQB 410**

**Date:** 20150625

**Docket:** 1201 10775

**Registry:** Calgary

Between:

**Capital Direct Lending Corp. and Capital Direct I Income Trust**

Plaintif

- and -

**Howard & Company Real Estate Appraisers and Consultants Inc., David Horn and D.R.**

**(Rick) Howard**

Defendants

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## Memorandum of Decision

of

**A. R. Robertson, Q.C., Master in Chambers**

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### Introduction

- [1] Capital Direct Lending Corp. (“Lending Corp.”) and Capital Direct I Income Trust (“Income Trust”) sue an appraisal company and two of its employees on the basis that the appraisal was materially incorrect at the time a mortgage loan was advanced by Lending Corp. in 2007. I will refer to the defendants collectively as the “appraiser”.
- [2] The appraiser defends and asks that the claim be summarily dismissed.
- [3] Arguments relating to the accuracy of the appraisal itself are not before me. The issues are:
- (a) The client was Lending Corp. Can a related entity, Income Trust, sue in light of limiting words in the appraisal?

- (b) The loss resulted after an intervening renewal, long after the appraisal was given. If the lender chose to renew without an updated appraisal, can it claim damages from the appraiser?
- (c) Is the claim statute barred?
- (d) Is the claim sustainable, because the lawyers registered the mortgage against the tile to the wrong lands?

## **Facts and Submissions**

[4] The facts are not in dispute. The description of some of them, and the application of the law to the facts, are in dispute.

### **Retainer of the Appraiser**

[5] The plaintiffs explain that when a borrower applies for a loan secured by a mortgage the underlying appraised value of the property is the primary factor used by the lender to evaluate the amount of funds to be advanced. Here the lender ordered an appraisal through the National Appraisal Service, which selects appraisers on a randomized basis and transmits the lender's request and requirements for the appraisal to an appraisal firm. The defendant corporation was selected using this service for the purpose of refinancing a lender on October 27, 2008.

### **The Client**

[6] The appraisal, dated effective October 29, 2008, was specifically addressed for the use of "Capital Direct" with no specific identifier of whether it was Lending Corp. or Income Trust. It contained limiting conditions that prevents anyone but the client from relying upon the appraisal.

Emails from and to the lender show "Capital Direct Lending Corp." as the client, and the mortgage was registered in the name of "Capital Direct Lending Corp." The appraiser sent its account to "Capital Direct Lending Corp." There appears to have been no communication to the appraiser that any other entity might be involved with Lending Corp. The reference in the appraisal itself to "Capital Direct" reflects the name that appears on the logo that is used by Lending Corp. But also by related companies.

### **The Loan and Mortgage History**

[7] The appraisal performed by the defendants was stated to be effective August 20, 2008 and the opinion was that the market value of the fourplex was \$430,000. Lending Corp. took a second mortgage based on that appraisal of the lands, and advanced the funds.

[8] The mortgage receivable was later sold to Income Trust, by way of formal transfer of the loan and security. A letter dated April 17, 2009 from Lending Corp. was addressed to "Capital Direct Management Ltd. in its capacity as Manager of Capital Direct I Income Trust". It came from Lending Corp.'s Calgary office to a "Capital Direct Management Ltd." office in Vancouver, and it began quite formally,

Dear Sir/Madam,

Please be advised that we have arranged for you to purchase the aforementioned mortgage as of April 17, 2009. Please have certified funds payable to [XYZ], Barristers & Solicitors ready for pickup on April 17, 2009 to facilitate the sale of the mortgage.

[9] The solicitors for Lending Corp. later reported on the transfer of mortgage to "Capital Direct Management Ltd." in a very formal letter which included the following entry: We confirm that we only act on behalf of Capital Direct Lending Corp. in effecting the transfer of this mortgage to you. We have

received no other instructions relating to this transaction and that you have acknowledged this fact prior to our registering the transfer.

[10] A bank draft was sent on April 7, 2009 from “Capital Direct” in Vancouver to the solicitors in Calgary for “the purchase of the aforementioned mortgage by Capital Direct 1 Income Trust”.

[11] However, the mortgage registration at the Land Titles Office was not affected. The mortgage remained registered in the name of Lending Corp. despite the fact that it had clearly sold it to Income Trust. Income Trust’s “manager”, and apparently trustee (having purchased the mortgage on its behalf) was Capital Direct Management Ltd., but it did not record anything on title.

[12] Of course, section 47 of the *Land Titles Act*, R.S.A. 2000, c. L-4 prevents any reference on a certificate of title to a trust, and any trustee is deemed to be the absolute and beneficial owner of the land for the purposes of the *Act*.

[13] The mortgage came due and it was renewed. The proposal for mortgage renewal was sent to the borrower by an individual on letterhead of “Capital Direct”, but it is signed, “Authorized signatory of Capital Direct Lending Corp.”

[14] The draft Mortgage Renewal Agreement, dated December 9, 2009, was signed by that same individual on behalf of Lending Corp., but as well, there is a place at the bottom of that document for signature by an “Authorized Signatory of Capital Direct Management Ltd. in its capacity as Manager of Capital Direct I Income Trust (Mortgagee)”.

[15] With that document is a Statement of Loan Payments requesting a signature by the borrower, “to confirm the Payment History, Balance and Renewal at the said interest rate.” That page is signed on behalf of “Capital Direct I Income Trust.” That is, there is no reference on the Statement of Loan Payments to an intervening management company, let alone to Lending Corp.

[16] These documents are accordingly confusing as to the identity of the mortgagee. However, the documents referenced above make it clear that at the time the mortgage debt and security was owned by Capital Direct Management Ltd. in its capacity as Manager of Capital Direct I Income Trust.

[17] The appraiser says that the renewal was a new transaction, it occurred about a year and a half after the effective date of the appraisal, and there was not, and should not have been, any reliance by the lender on the appraisal at that time. It was well over a year old.

[18] The plaintiffs say that the money had already been lent by then, and security taken. The lender’s choices at that point were to renew or demand re-payment. Had the plaintiffs done so here, the flaws in the appraisal would have been found sooner, but the claim would have played out the same. Perhaps the quantum of the ultimate shortfall would have been different.

### **Default and Foreclosure**

[19] After renewing the mortgage, the borrower defaulted. But by then Income Trust owned the loan and the mortgage. Accordingly, the appraiser says the loss was suffered by Income Trust, not the client Lending Corp. The appraiser never provided an appraisal to Income Trust.

[20] Therefore, the appraiser argues that the mortgage that was foreclosed was a different transaction, and the mortgage was owned by someone not its client. The appraised value was clearly out-of-date by then in any event.

[21] However, the original mortgage remained on title in the name of Lending Corp. and the foreclosure proceedings were brought in the name of Lending Corp. The statement of claim made no reference to the existence of Income Trust.

## **The Internal Arrangements**

[22] Had the borrower paid close attention to the documents placed before her at the time of renewal she would have been hard-pressed to understand the relationship between Lending Corp., Capital Direct Management Ltd. and Income Trust in light of the renewal documents that made various references to those entities.

[23] Notwithstanding the clear formal sale of the mortgage receivable and security by Lending Corp. to Income Trust, these companies, which I am advised are related, interact with their customers somewhat casually as, “Capital Direct”, without clearly identifying which company is involved.

[24] The plaintiffs have placed in evidence a copy of the mortgage broker agreement made by Capital Direct Management Ltd. on behalf of Capital Direct I Income Trust as “manager” and

Lending Corp. as “mortgage broker”. That agreement provides that Capital Direct Management Ltd. appoints Lending Corp. as “mortgage broker”. Accordingly, internally within Capital Direct as a group of companies, Lending Corp. is nothing more than a mortgage broker, as we are told by this agreement. No one, however, appears to have told either the borrower (at least, not clearly) or the appraiser of the existence of anyone other than Lending Corp.

[25] As mentioned below, the affidavit now filed on behalf of the plaintiffs says the relationship of the companies is different, with no documentary support for the statement.

## **The Limiting Words**

[26] The appraisal specifically limits who may use and rely upon the appraisal under the heading “Assumptions & Limiting Conditions”. It says this:

The certification that appears in this appraisal report is subject to the following conditions:

1. This report is prepared at the request of the client and for the specific use referred to herein. It is not reasonable for any other party to rely on this appraisal without first obtaining written authorization from the client, the author and any supervisory appraiser, subject to the qualification in paragraph 11 below. Liability is expressly denied to any person other than the client and those who obtain written consent and, accordingly, no responsibility is accepted for any damage suffered by any such person as a result of decisions made or actions based on this report. Diligence by all intended users is assumed.
2. Because market conditions, including economic, social and political factors change rapidly and, on occasion, without warning, that market value estimate expressed as of the date of this appraisal cannot be relied upon as of any other date except with further advice from the appraiser and confirmed in writing.
3. The appraiser will not be responsible for matters of legal nature that affect either the property being appraised or the title to it. No registry office search has been performed and the appraiser assumes that the title is good and marketable and free and clear of all encumbrances including leases, unless otherwise noted in this report. The property is appraised on the basis of it being under responsible ownership.

[27] The appraisal report goes on to set out various other “Assumptions & Limiting Conditions”.

## **Discovery of the Concern**

[28] Shortly after the default, Income Trust learned that the property was at that time not worth anything close to the original appraised value, and the appraiser argues that it should have been put on

inquiry then. Accordingly, the appraiser argues that the limitation period for the claim began at that point, or shortly after; the claim was advanced more than two years later and is therefore statute barred.

[29] The evidence of Mr. Tripp, for the plaintiffs, is that when it was seeking foreclosure relief it was not aware that the defendants' appraisal had been negligently performed. The current appraisal it was relying on for the foreclosure was based on an exterior inspection only. It showed a market value of \$250,000 and a forced sale value of \$187,000. At that forced sale value there would have been a shortfall. The defendants' appraisal had opined that the market value in August 2008 was \$430,000.

[30] Mr. Tripp deposed that there were other factors that could have led to a lower value being reflected in the foreclosure affidavit of default. Furthermore, in cross-examination he said that as at June 25, 2010 when he learned of the appraisal used in the foreclosure, he did not believe that the plaintiffs would suffer a loss, or if they did it would not be significant enough to justify legal action.

[31] The defendants argue that the plaintiffs should have realized that in a foreclosure the "forced sale value" was the figure that was most meaningful, because (they argue) foreclosures rarely involve sales at the fair market value.

[32] The shortfall was established when a final order for foreclosure was obtained on August 31, 2011. The plaintiffs have obtained a historical appraisal done on October 15, 2012 expressing the opinion that the value of the fourplex as at August 20, 2008 was \$255,000, not \$430,000.

[33] The plaintiffs say that the time issue is a red herring. The loan would not have been advanced at all, at least not in the amount advanced, but for the error in the appraisal. As to the limitation, they say that the intervening time between the appraisal and the ultimate default and foreclosure proceeding – one of the factors the appraiser says works to its benefit – meant that the plaintiffs were not put on enquiry merely because of the discrepancy. Too much time had passed for that. It was only when matters were looked into more closely and an historical appraisal was obtained that the error by the appraiser was understood. They say that, until then, they did not know the loan should never have been advanced and that the appraisal was wrong at the outset. They argue that the limitation period started running only when they obtained the historical appraisal. Therefore, they brought the claim in time.

### **Error in Registration**

[34] To complicate matters, the mortgage was registered against the wrong property. It was registered on the title to a vacant lot next to the fourplex rental building. This is an error of legal counsel. The plaintiffs say they have settled that claim by looking to title insurance, and it is not relevant to their claim against the appraiser except arguably as to quantum. That settlement was based upon the position the plaintiffs would have been in had the mortgage been registered against the correct property. This claim is for damages resulting from the errors in the appraisal.

## **Analysis**

### **Intervening Renewal of Mortgage**

[35] The appraiser argues that the lender(s) should not have renewed without getting a new appraisal.

[36] If the lender had either not renewed the mortgage or required a new appraisal before agreeing to renew, the alleged problem with the appraisal would simply have come to light earlier. The defendant appraiser argues that the lender did not have to renew, and the contract allowed the lender simply to call the loan due according to the terms of the mortgage because the term had expired. However, that approach assumes that the borrower had the cash available to pay out the debt, or that another lender would refinance the property. It takes a great leap of faith to believe that the borrower might have had the cash available to simply pay the debt.

[37] If the original appraisal was so far “out of the market” as is alleged, it is not a proper inference that another lender would have refinanced. Another lender would have required an appraisal at that time, the error in the original appraisal would have been discovered, the new lender would not have advanced, and the claim now advanced against the appraiser would simply have been advanced earlier.

[38] While this analysis might be described as speculative, if the facts are as alleged by the plaintiff, then this outcome (an earlier discovery of the issue) seems extremely likely. Only the term and the interest rate that would have been amended at the time of the renewal of the mortgage. While, for some purposes, this might be considered a “new” mortgage (see, *e.g.*, the parallel decisions of the Alberta Court of Appeal in *Collingwood Investments Ltd. v. Bank of America Canada Mortgage Corp.*, 58 Alta L.R. (2d) 1 and *Paramount Life Insurance Co. v. Torgerson Development Corp. (Alta) Ltd.*, 58 Alta. L.R. (2d) 13), the concept of a renewal is generally not considered to have that effect.

[39] In my view, in these circumstances the renewal simply allowed more time to pass before the issue was discovered.

### **Limitations Issue**

[40] The argument that the plaintiffs should have been put on enquiry about a shortfall and that error in the defendants’ appraisal involves a finding of fact. The evidence from the plaintiffs directly puts this factual matter in issue, so it is not an issue capable of being resolved summarily.

[41] The fact that the affidavit of value used in the foreclosure showed a forced sale value that would result in a deficiency is challenged by the plaintiffs, and in the experience of the Court it is not correct to say that the forced sale value has great weight. Properties are routinely listed for sale with a real estate agent at the fair market value or such higher listing price as the agent believes is appropriate. Offers are often received close to or even above the appraised value, and where there are multiple interested potential purchasers the final price put forward for acceptance by the court is sometimes well above the appraised “fair market value”. Sometimes the listing price must be lowered to find a buyer at a price well below the “forced sale value” as it was originally appraised. Sometimes there are no offers at all.

[42] In the sequence of events here, the world economy suffered a major blow in October 2008, shortly after the mortgage was first taken. The fact that lower values were appearing at the time of the foreclosure proceeding would not, by itself, set off alarms.

### **Registration Against Wrong Lands**

[43] This is not a defence to the claim and it does not lead to summary dismissal. The plaintiffs have secured a settlement through title insurance that, in their view, places them in the position they should have been in had the mortgage been registered properly, but that still leaves the claim advanced against the defendants. The defendants may disagree with the settlement and that may be a factual issue for the trial judge, but the issue is one of quantum of damages, not a complete defence to liability capable of summary resolution.

### **Limiting Words in the Appraisal**

[44] The claim advanced against the appraiser is one of negligent misrepresentation. It is based on the principles identified in *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*, [1964] A.C. 465, [1963] 2 All E.R. 575, but it is sometimes forgotten that the claim in that case was dismissed because there was an express disclaimer of responsibility. As was stated by Lord Devlin at the conclusion of his reasons:

A man cannot be said voluntarily to be undertaking a responsibility if at the very moment when he is said to be accepting it he declares that in fact he is not. The problem of reconciling words of exemption with the existence of a duty arises only

when a party is claiming exemption from a responsibility which he has already undertaken or which he is contracting to undertake.

[45] The plaintiffs refer to *Esselmont v. Harker Appraisals Ltd.*, 1979 CarswellBC 228, 14 B.C.L.R. 116, at para. 1, where the Court said:

An appraiser of real estate owes a duty of care not only to the client on whose instructions he prepares his appraisal but to all other persons to whom it may be shown and who might be expected to rely on it in dealing with the subject matter by way of purchase, mortgage, security or otherwise.

[46] A previous B.C. Supreme Court case was referenced, which in turn referenced *Hedley*

*Byrne & Co. Ltd.* However, no reference is made to any limiting words such as we see above. A similar point is made in *Royal Bank v. Richardson Appraisals Inc.*, 2003 BCSC 718, 2003 CarswellBC 1100 at para. 17, where the duty to the plaintiff (not privy to the contract) was not challenged.

[47] I accept that in the absence of words in the appraisal limiting its use there may be reliance by other parties who are not privy to the contract with the appraiser.

[48] However, the appraisal says here very clearly that the appraiser was contracting with Lending Corp. and no one else. It clearly stated that it was not reasonable for any other party to rely upon the appraisal without first obtaining written authorization. There is no evidence of such authorization being sought. The appraiser was not advised of any agreement whereby Lending Corp. was merely a broker for someone else. And the facts disclose the funds were advanced by Lending Corp. and later on the mortgage was sold to Income Trust and Lending Corp. was paid out.

[49] Therefore, although foreclosure proceedings were done in the name of Lending Corp., the loss was actually suffered by Income Trust, not Lending Corp. Lending Corp. merely lent its name to the proceedings. The mortgage registration should have been transferred to Capital Direct Management Ltd. as manager for Income Trust. The proceedings properly should have been conducted in the name of Capital Direct Management Ltd. as trustee and agent for Income Trust.

[50] Lending Corp. had been paid out, as demonstrated by the bank draft sent to its counsel long before the renewal and long before the default.

[51] However, the managing director of both Lending Corp. and Income Trust explained in his affidavit that Lending Corp. is named as the nominee to hold title to the mortgages and monies secured for and on behalf of Income Trust, and it holds the title to mortgages as bare trustee for the Income Trust and that the income trust is responsible for all of its obligations as a mortgage holder under the mortgages in its portfolio.

[52] He asserted in his affidavit that, "The funds for the mortgage in question were at all times advanced by the Income Trust."

[53] However, that is directly contrary to the documents that have been provided by the entities that he manages. The funds were initially advanced by Lending Corp., and *then* it *sold* the mortgage to Income Trust. It was paid out. If it was using Income Trust's money to advance the mortgage loan, there would have been no reason for it to be paid on that sale.

## **Conclusion**

[54] The limiting words in the appraisal are clear. The appraisal was only to be relied upon by the client, and that client was Lending Corp. There is no evidence that Income Trust relied on the

appraisal at all. It seems likely that Income Trust simply assumed that all had been done properly at the time the loan was advanced. Lending Corp. suffered no loss, because it had been paid out.

[55] Although Mr. Tripp deposed that Lending Corp. was a bare trustee for Income Trust, and that the loan was advanced by Income Trust, the documents simply do not support his description of the facts. In fact, he is giving an opinion of the legal relationships between the corporations and the trust, but the agreements themselves, and the documents demonstrating the sale from Lending Corp. to Income Trust, do not support his assertion.

[56] Accordingly, the application to dismiss is allowed. The intervening renewal, the limitations argument and the registration against the wrong title do not lead to a summary dismissal of the claim, but the limiting words in the appraisal are a complete bar to a claim by Income Trust, and Lending Corp. suffered no loss.

[57] Costs may be spoken to if the parties cannot agree.

Heard on the 21<sup>st</sup> day of May, 2015.

**Dated** at the City of Calgary, Alberta this 25<sup>th</sup> day of June, 2015.

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**A. R. Robertson, Q.C.**

**M.C.C.Q.B.A.**

Appearances:

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