



The Essential Guide
to mortgages and
charges over land

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This Essential Guide describes the most commonly used types of security that can be created or arise over property, the form and contents of a typical mortgage or fixed charge over property, due diligence and pre-completion issues, potential challenges to security, how security over property is released and a lender's remedies under a mortgage or charge over property.

Overview

Types of security interest that can be created

What types of security can be created?

The following types of security interest can be created over property:

- Legal mortgage
- Equitable mortgage
- Equitable fixed charge
- Floating charge

The lender often takes security over property together with security over other assets owned by the borrower, in which case the security interest created over the property will usually be contained within a global security document referred to as a debenture. To create a particular type of security interest over property, the debenture must comply with the formalities that would be applicable were the security over property contained in a stand-alone security document. For example, if the debenture is to create a legal mortgage over property it must be executed as a deed by the borrower.

Who can benefit from security?

Generally, security interests over property are granted in favour of a single lender or, alternatively, a security trustee (or security agent) that holds the security on trust for a group of lenders.

What form do second and subsequent security interests take?

A borrower may create more than one security interest over its property. A second or subsequent security interest can be either legal or equitable, depending on the circumstances.

What is third-party security?

Third-party security describes security granted by someone other than the contractual debtor. It includes security given by a co-owner where only one of them is the contractual debtor.

Sometimes, third-party security is taken to mean security where the lender's recourse is limited to the asset over which the security has been taken (that is, the person who has granted the security is not personally liable to the lender if there is still debt outstanding after the security has been realised). This limited recourse can either be achieved by drafting the security document so that there is no covenant to pay or including a covenant to pay but limiting the lender's recourse to the assets which have been mortgaged or charged

Types of security and quasi-security interest that can arise

A security interest or quasi-security interest over property can arise in other situations and transactions, such as:

- By operation of law (for example, an unpaid

seller's lien or buyer's lien (or purchaser's lien) to secure a deposit).

- By an act of the courts (for example, a charging order).
- By statute (for example, under legal aid legislation).

The details

Legal mortgage

A mortgage involves the transfer of title of an asset by way of security for particular obligations on the express or implied condition that it will be retransferred when the secured obligations (or secured liabilities) are discharged. Possession of the mortgaged asset by the lender is not required. A mortgage can be legal or equitable; the difference being that a legal mortgage transfers legal title to an asset and an equitable mortgage transfers the beneficial interest in an asset.

Legislation has affected the way a legal mortgage over property is created. As a result of the Law of Property Act 1925 (LPA 1925), a legal mortgage of property is now normally created by the borrower executing a document creating a charge by way of legal mortgage, rather than by it transferring the legal title to the property to the lender. This is also sometimes called a "legal charge" so that the terms "mortgage" and "charge" have become largely interchangeable when referring to security over property. Technically they are different legal concepts.

Even though title is not transferred to the lender (as it is with a mortgage of other assets) this type of security interest gives the lender equivalent rights and creates a legal interest in the land.

For unregistered land only, a legal mortgage can also be created by a demise (or sub-demise for a leasehold property) for a term of years subject to a provision for cesser on redemption.

Equitable mortgage

An equitable mortgage involves the transfer of the borrower's equitable (that is, beneficial) interest in an asset to the lender by way of security for the performance of particular obligations, on the express or implied condition that such beneficial interest will be retransferred when the secured obligations are discharged. As only the beneficial interest in an

asset is transferred, an equitable (rather than a legal) security interest is created. A borrower must have a legal interest to create a legal mortgage over that interest.

In commercial lending transactions the usual ways of creating an equitable mortgage are by:

- An assignment by way of security.
- An agreement to create a legal mortgage if the following requirements are satisfied:
 - The borrower intended to transfer beneficial title to the lender by way of security, i.e. the borrower intended to create security with immediate effect (an obligation in a facility agreement, for example, that the borrower enter into a security document to create a legal mortgage if a certain event happens is unlikely to fulfil this requirement); and
 - The asset over which it is intended to create security is sufficiently identified.

Since 27 September 1989, it has not been possible to create an equitable mortgage by merely depositing the title deeds or the land certificate with the lender. This is so even if the deposit is noted on the title register of the property or there is a memorandum of deposit. Such deposit constitutes part performance of an agreement to create a legal mortgage and so section 2 of the Law of Property (Miscellaneous Provisions) Act 1989 must be complied with.

Equitable fixed charge

The term "charge" is often used by practitioners as a generic term for all types of security interest. In its technical sense, however, it is an agreement between the lender and the borrower, by which a particular asset can be appropriated by the lender, to the satisfaction of a debt owed to the lender. A charge does not transfer a legal or beneficial interest in the asset to the lender, nor does it confer a right to possession. Instead, the lender has a right to resort to the asset in order to realise it so as to pay off the debt. A charge, in the technical sense, is an equitable security interest (other than when used in the context of a charge expressed to be by way of legal mortgage (see **Legal mortgage**)).

A charge can either be fixed or floating. The key characteristic of a fixed charge is that it gives the lender control over the charged asset. This control is crucial to the nature of a fixed charge: without sufficient control by the lender over the asset, the charge will be floating and not fixed.

Floating charge

A floating charge is a charge in favour of the lender over all the assets or a class of assets owned by the borrower from time to time as security for particular obligations. A floating charge has the following characteristics:

- It is a charge on a class of assets, present and future of the borrower.
- That class is one that, in the ordinary course of the borrower's business, changes from time to time.
- It is contemplated that until some future step is taken by or on behalf of those interested in the charge, the borrower may carry on its business in the ordinary way as far as it concerns that particular class of assets, including the disposal of such assets without the consent of the lender.

A floating charge can convert, or crystallise, into a fixed charge if certain events occur. A floating charge may crystallise over all the assets subject to it (which is most common), or just some of them if the lender so decides (but this is rare). As a consequence of crystallisation, the borrower's ability to deal with the affected assets is restricted.

Form and contents of a mortgage or fixed charge

The form and content of a mortgage or fixed charge will largely be determined by the type of property being mortgaged or charged and the context of the transaction.

The Land Registry does not require a particular form, although a legal mortgage of registered land can be in form CH1 its use is not mandatory (regulation 103, Land Registration Rules 2003 (SI 2003/1417) (LRR 2003)). The Land Registry was also consulting on rules which would extend the use of electronic legal charges for residential property. It was thought that any such rules, if introduced, may later be applied to commercial property. However, the Land Registry

subsequently announced that it had put electronic conveyancing on hold for the immediate future.

In some cases, the security document may be relatively short and incorporate by reference a longer document, typically the facility agreement. Lender's should be aware that if a legal mortgage is registered or an equitable security interest is noted by way of agreed notice at the Land Registry, the document creating it is open to public inspection unless and to the extent it has been designated as an "exempt information document". Sensitive or confidential information should, therefore, not be contained in a security document.

Scope of a mortgage or fixed charge

Appurtenant rights and fixtures

Unless a contrary intention is expressed, a mortgage or charge of land extends automatically to appurtenant rights, such as buildings on that land, and to fixtures since these are part of the land (section 62, LPA 1925), whether or not the fixtures are created or fixed before or after the mortgage is created. There is an exception in relation to trade fixtures installed by a tenant under a lease granted while the borrower is in possession which remain the property of the tenant.

A mortgage will not extend automatically to chattels or insurance policies relating to the land. If security is required over these ancillary assets the security document will need to be amended as appropriate, but security over chattels is problematic if the borrower is an individual. A lender is likely to want to take security over chattels if the mortgaged or charged property is being run as a hotel.

Contents of a security document

A security document creating a legal mortgage will usually contain the provisions outlined below, unless it is in form CH1. Similar provisions are likely to be included in a security document creating either an equitable mortgage or an equitable fixed charge, unless otherwise indicated below or that security has been created in a relatively informal way.

Charging provision

The security document should contain a charging provision specifying:

- Who is granting the security.

- In whose favour the security is being granted.
- The type of security being granted by the borrower (for example, a legal mortgage, an equitable mortgage or a fixed charge).
- Whether the security is being given with full title guarantee or limited title guarantee.
- The assets over which the security is being granted (see **Description of the property**).
- The obligations that security will secure (for example, all monies owed by the borrower to the lender or the monies owed under a specific agreement such as a facility agreement).

Description of the property

The security document should contain a description of the mortgaged or charged property. For a legal mortgage of registered land, the land must be identified by its title number(s). While a fixed charge or equitable mortgage may give specific details of the property, it can be identified more generically – for example, “all the borrower’s right, title and interest, both present and future in any freehold, commonhold or leasehold property (other than property subject to an effective legal mortgage under this security document)”. However, if a generic description is used the assets subject to the security must be capable of being identified when the security is required to be enforced.

Covenant to pay

A covenant to pay (that is, to pay or repay the liabilities secured by the security created by the security document) should be included as this assists in determining when the lender may exercise its rights to enforce the security. Covenants to pay in modern bank security documents are usually to pay “on demand” by the lender. Sometimes, this is qualified by the words “when they become due”. This is to avoid a committed facility becoming an on demand facility. However, it is arguable that the words “when they become due” are not strictly necessary because demand is only validly made when the loan is due under the terms of the facility agreement.

Further advances

A security document often contains a further advances clause to try to ensure that further lending takes

priority over amounts lent and secured by security created in favour of others after the initial loan was made. The effect of this clause on priority will differ depending on the type of security created and whether the land is registered or unregistered.

Release of security

A security release clause may be included under which the lender confirms that it will release the security once it is satisfied that the secured obligations have been paid in full.

A lender should not include terms that could be characterised as a clog on the equity of redemption or a collateral advantage.

Enforcement powers

A lender holding a mortgage or charge made by deed will have a statutory power of sale out of court and a right to appoint a receiver out of court, although the statutory power of sale in the case of equitable security interests may be limited.

These statutory powers are generally regarded as inadequate and most security documents will contain express provisions that modify or extend the statutory powers. For example, a security document will usually:

- Grant an express power of sale to the lender, and set out when that power is exercisable. Typically, this is done by stating that the statutory power of sale under section 101 of the LPA 1925 arises on (and is exercisable at any time after) execution of the security document, but that the lender will not exercise its power of sale until the security constituted by the security document has become enforceable (this is likely to be when an event of default has occurred under the related facility agreement).
- Contain an express power for the lender to appoint a receiver at any time after the security constituted by the security document has become enforceable (for example, following an event of default under a related facility agreement). The express power will also allow appointment whether or not the property produces an income.
- Extend the statutory powers of the receiver, in particular by giving the receiver a power of sale.

The borrower will also agree to pay the lender's enforcement costs.

Representations and warranties

The lender may require representations and warranties to be given by the borrower. These set out a suggested set of factual circumstances about the property (and, sometimes, the borrower if these are not included in a related facility agreement) on which the lender has based its decision to lend. For example, representations may be included in the security document about the property's planning status or the borrower's compliance with environmental laws in relation to the property.

Negative pledge

A security document will usually include an undertaking whereby the borrower agrees not to create (or allow to subsist) any other security over the property without the lender's consent. This type of clause is referred to as a negative pledge.

Restrictions on disposal

Security documents commonly include a restriction to prevent the borrower disposing of the property or granting third-party rights without the lender's consent. This restriction is entirely separate from any restrictions on leasing (see **Restrictions on leases**).

If the lender has a legal mortgage it will usually reinforce its security by registering a restriction in Form P against the title to the mortgaged property at the Land Registry. A Form P restriction means that the Land Registrar will not register a disposition of the property (including by way of a transfer or grant of a charge over the property) without the lender's written consent.

A Form P restriction cannot be registered when the security is not substantively registered (that is, it is an equitable security interest). However, if that security is protected by a notice, then a restriction in Form N can be registered. A Form N restriction provides that there can be no disposition of the registered estate without the written consent of a specified person (which, in this case, would be the lender).

Restrictions on leases

Leases or other occupation rights granted in respect of the property could reduce its value so the lender will want to prohibit the borrower from granting these without its written consent. Similarly, the lender will want to stop the borrower dealing with any leases that are in existence (for example, by accepting their surrender or consenting to an assignment of a lease to a new tenant). It is standard to exclude the borrower's statutory powers to grant and accept surrenders of leases under sections 99 and 100 of the LPA 1925.

There may also be undertakings relating to managing the property (for example, to enforce the lease covenants against the tenants, collect rent, and use best endeavours to let or re-let vacant units).

Other undertakings

The borrower usually gives certain other undertakings (also known as covenants) in relation to the property, unless these are contained in another document (for example, a facility agreement). Common undertakings include:

- To keep the property in repair.
- To comply with laws, including environmental laws, relating to the property.
- To insure the property (the lender's statutory powers of insurance under sections 101 and 108 of the LPA 1925 are generally regarded as insufficient).

Due diligence and pre-completion issues

This section assumes (unless otherwise indicated) that the lender is intending to take a legal mortgage as part of a specific transaction.

Issues to consider before taking a legal mortgage

Is there a risk that the security will be void?

The lender's lawyers may need to take steps or make enquiries to minimise the risk that the security will be void, for example because of undue influence or because the transaction is reviewable due to the borrower's subsequent bankruptcy or insolvency (see **Challenges to security**).

Does the borrower have capacity to give the security?

A prudent lender will check that the borrower has capacity (for example, in its constitutional documents or, in the case of a trustee, its trust deed) to enter into the security.

Is landlord's consent required?

If the property is leasehold, the lender should check the alienation covenants in the lease to see if the required security can be taken or whether landlord consent is needed for its creation. The lender should also check whether there are any restrictions on the lease being assigned as this is how the lender would sell the property in an enforcement situation (see **Enforcement issues with security over leasehold property**).

A lease covenant prohibiting charging will be breached by a charge by way of legal mortgage. The covenant may be qualified (that is, there is not an absolute prohibition on charging but the tenant must obtain the landlord's licence or consent). If landlord's consent is required there may be a proviso that landlord's consent is not to be unreasonably withheld. This could be express or implied by section 19 of the Landlord and Tenant Act 1927. There is no authority on whether the creation or crystallisation of a floating charge would breach such a covenant (although this would obviously breach a specific covenant against creating floating charges).

A covenant in the lease against underletting will be breached by a mortgage by sub-demise but probably not by a charge by way of legal mortgage. Mortgages by sub-demise are now rare.

If there is a proviso that landlord's consent is not to be unreasonably withheld (whether express or implied by section 19) the landlord has a statutory duty not to unreasonably withhold consent (section 1, Landlord and Tenant Act 1988). The duty is owed to the tenant (that is, the borrower) and not the lender.

Will the property provide "sound" security in terms of its title?

The lender needs to be sure that:

- It will have good and marketable title to the property and can sell it in the future if it has to

enforce its security, and realise enough money to cover the debt secured on the property.

- It is aware of potential liabilities that it may have in relation to the property by taking the security or if it becomes a mortgagee in possession.

The lender's lawyers may carry out the investigation and give a report on title to the lender. Warranties may be given by the borrower to support that investigation.

Alternatively, the lender may rely on the borrower's lawyers to carry out the investigation and certify the results of that investigation. In transactions involving commercial property, the certification often takes the form of a City of London Law Society (CLLS) Land Law Committee certificate of title or will be based on this.

Sometimes, if security is being taken over a portfolio of properties, the lender's lawyers will investigate a selection of properties (strategic, flagship or a random sample), with the borrower's lawyers carrying out and certifying the investigations for the remainder of the properties.

Overriding interests, particularly those in favour of persons in actual occupation, have given rise to much litigation with lenders over the years.

The Court of Appeal considered the priority of interests between lenders and occupiers under a sale and lease back scheme in *Cook and others v The Mortgage Business plc and others* [2012] EWCA Civ 17. It held that the occupiers had no equitable rights capable of being overriding interests under the LRA 2002 and the lenders' rights under the charges, therefore, had priority. Although perhaps of no comfort to residential occupiers, this decision will provide reassurance to lenders who provide finance to purchaser landlords in such schemes (often to special purpose vehicles in large-scale residential developments).

Will the property provide "sound" security in terms of its value?

In most cases, the lender will instruct valuers to value the property. The loan to value ratio is one of the key measurements of the risk the lender is taking.

As well as assumptions and information about the title to the property, the valuation will be informed by a survey of the property.

A certificate of title will usually include a statement that there is nothing in the valuation report that

is inconsistent with the certificate. One type of inconsistency would be that the assumptions made by the valuers are not borne out by the legal facts and circumstances.

Litigation by lenders against valuers over negligent valuations following default by the borrower on the loan is not uncommon.

Are there any environmental issues?

If contamination at the property is a possibility, the lender may require detailed investigations, indemnities, insurance or a combination of these. If problems are revealed, the lender may refuse to lend since a lender can be liable for contamination (including historic contamination) under Part IIA of the Environmental Protection Act 1990 (see **Taking possession**).

Environmental liability, generally, is a growing area of concern in the UK and as a result lenders are increasingly taking a more cautious approach to environmental risk. For example, as part of its due diligence, a lender may need to check if the borrower has to participate in, and buy carbon allowances under the CRC Energy Efficiency Scheme (CRC). The CRC is a UK-wide mandatory emissions trading scheme, which applies to large businesses and public sector organisations.

Pre-completion searches: land registry and land charges department

When the parties are ready to complete the security, the lender or its lawyers need to carry out certain checks to ensure that once granted, the security can be properly registered or protected at the Land Registry or Land Charges Department.

Registered land: legal mortgages

If a legal mortgage is being taken over registered land, the lender's lawyers will carry out a pre-completion priority search at the Land Registry. No agreement to grant the security is required, it is sufficient that the prospective lender intends to take a legal mortgage.

The search gives a priority period of 30 days in which the completed legal mortgage must be registered. The effect of this is that:

- If the legal mortgage is registered within the priority period, the lender will take the property

free of any other application that has been lodged during the priority period by any other person.

- If the legal mortgage is not registered within the priority period, the lender may find that another person has applied to register an interest against the property and that other interest may take priority over the legal mortgage, so that the lender would have to take the property subject to that other interest.

It is possible to submit a second priority search to acquire a second priority period. This can be done before or after the priority period conferred by the first priority search expires. However, a second (or indeed subsequent) priority search will not actually extend the first priority period. This means that if the legal mortgage is registered within the priority period of the second search, the lender will take free of any application lodged during that second priority period but subject to any application lodged during the first priority period. Any such pending application should be revealed by the second priority search and may give rise to contractual remedies or obviate a contractual obligation to advance the loan. Nevertheless, this is not satisfactory and a notice should be lodged if the initial 30 day priority period will be exceeded (see **Registered land: noted security interests**).

Registered land: noted security interests

If the security will not be substantively registered but will be protected by a notice, a Land Registry priority search cannot be made, but a search without priority can be. This is done by making an outline application once the security interest exists.

Unregistered land: grant of security to be followed by first registration

If registration of the property will be triggered by the grant of the security or is otherwise going to be registered the following should be noted:

- A Land Registry priority search cannot be carried out before the security document is executed because the land is not yet registered land.
- If there is a prior agreement to enter into the legal mortgage, a caution against first registration may be registered by the lender (section 15, LRA 2002).

- Where a person is under a duty to make an application for first registration and there is a dealing with the relevant estate, then the LRA 2002 applies to the subsequent dealing as if that dealing had taken place after the date of first registration (rule 38, LRR 2003).

Insolvency searches

Searches should be carried out to check that there is no evidence of the borrower being insolvent. If the borrower is a company, the lender should carry out searches at:

- Companies House.
- Central Registry of Winding-Up Petitions (0906 7540043).
- The Land Charges Department (if the property over which security is to be granted is unregistered).

Other than the Land Charges Department searches, these searches do not confer any priority and so should be carried out as close to completion as possible.

Formalities

Various formalities must be complied with for there to be a valid security interest over property. These include:

- The security being created by a written document.
- The security document being executed as a deed.
- The security document being executed by the borrower or, in some cases, by both the borrower and the lender.

The applicable requirements depend on the type of security interest, whether the interest in property subject to the security is legal or beneficial, whether the land is registered or unregistered and the identity of the borrower.

Perfecting the security

Stamp Duty Land Tax

Security over property is not liable to stamp duty land tax (SDLT) when it is created.

If a property is transferred subject to security and the buyer assumes the debt, then the amount of the debt is chargeable consideration for the purposes of SDLT.

Registrations to perfect security

A security or quasi-security interest over property may need to be registered at Companies House, in the borrower's statutory books and at the Land Registry.

The steps required vary depending on:

- The type of security interest (for example, a legal mortgage, an equitable fixed charge or a charging order).
- Whether the property interest subject to security is legal or beneficial.
- Whether title to the property is registered or unregistered at the Land Registry.
- The identity of the borrower (for example, a company, an LLP or an individual).

Completion of these registrations is often necessary to make the security valid against third parties or to achieve a particular priority position.

Notices to landlords and prior lenders

Notice of a security interest may need to be given to:

- The landlord of leasehold property, if required by the terms of the lease.
- Each prior lender in order to take priority over further advances made under the security in favour of that prior lender.
- Third parties where the security is in respect of an equitable interest in property (for example, if the equitable interest arises under a trust, the trustees).

Challenges to security

Misrepresentation

Equity allows the victim of misrepresentation to rescind a contract which the victim was induced to enter into by the statement made. This remedy is usually only exercisable where the other party to the contract has made the misrepresentation relied upon (for example, if the lender has made a misrepresentation to the borrower). However, the *House of Lords in Barclays Bank Ltd v O'Brien and another* [1993] UKHL 6 held that a misrepresentation made by a husband to procure that his wife give a guarantee would give rise to an equitable right for the wife to have that guarantee set aside if the bank had notice (including constructive notice) of the misrepresentation. This view was

confirmed by Lord Nicholls in *Etridge* (at paragraph 42). The same principles would apply to third-party security as to guarantees.

The same principles as for undue influence apply to establish when a bank will have constructive notice of any rights that a wife (or other guarantor) might have to have a guarantee or security set aside for misrepresentation and how that bank can avoid being fixed with constructive notice.

Insolvency

After new security has been granted, it is vulnerable to being set aside within certain time limits under the Insolvency Act 1986. Transactions that may be reviewed include:

- Transactions at an undervalue.
- Preferences.
- Floating charges created for existing debt for no new consideration.

Failure to register

Failure to register or protect security at the Land Registry or the Land Charges Department will generally only have priority consequences rather than the security being void against the borrower.

Failure to register security granted by a company or LLP at Companies House that is required to be registered under the Companies Act 2006 will render the security void (so far as any security is conferred by it) against the liquidator, the administrator and any creditor of the company or LLP (other than the lender).

Other potential challenges to security

A lender may find that its security is challenged for a number of other reasons. Some of these are matters of general law, others are specific to security. They include:

Duress. Where a party to a contract is induced by duress (actual or threatened violence or unlawful restraint) it is voidable by the injured party.

Mistake. The general rules of law on mistake and rectification apply to security. Where rectification would involve an alteration of the register, the relevant land registration rules and procedures must be followed.

Illegality. Security may, in certain cases, be prejudiced because of fraud or forgery. It may also be open to challenge as having been given in connection with an illegal transaction. Another example of illegality is security that breaches the financial assistance rules under sections 677 to 683 of the Companies Act 2006 (or the predecessor regime under sections 151 to 158 of the Companies Act 1985).

Clogs on the equity of redemption. Provisions in or relating to a mortgage that are clogs on the equity of redemption or collateral advantages to the security may be unenforceable.

Borrower's capacity. A company's objects may prevent it giving security over its assets for the debt of another company (although the lender may be protected by section 40(1) of the Companies Act 2006, but this was not wholly free from doubt in relation to its predecessor, section 35A of the Companies Act 1985).

Release of security

Registered land

Paper forms of discharge for legal mortgages: forms DS1 and DS3

If the land is registered, the usual way to discharge a legal mortgage is by the lender executing:

- A form DS1 (and sending it to the Land Registry under cover of either form DS2 or form AP1).
- If the discharge is of part only of a title, a form DS3 (and sending it to the Land Registry under cover of form AP1).

No fee is payable to the Land Registry for registering the discharge of a legal mortgage.

Other methods of discharging legal mortgages

The Land Registrar has discretion to accept any other proof of satisfaction of a legal mortgage that he regards as sufficient (rule 114(4), LRR 2003).

Electronic discharge of legal mortgages

Some lenders use an electronic discharge (ED) or E-DS1 to discharge registered legal mortgages, although this is more common in the context of residential mortgages.

Removal of restrictions

Generally, any restriction entry that specifically relates to the security being discharged will be cancelled automatically by the Land Registry when the security is discharged. A separate withdrawal in form RX4 may be required if the restriction does not specifically refer to the security being discharged.

Unregistered land

If the land is unregistered, a receipt endorsed on the security document naming the payer and which is executed by the lender operates as a discharge if the payer is the mortgagor (and this applies whether the security is a charge by way of legal mortgage or by way of demise) (section 115, LPA 1925). However, if the payer is not the mortgagor then the receipt operates as a transfer of the mortgage to the payer.

Any land charge registered at the Land Charges Department should be cancelled (using form K11 which needs to be signed by the lender or its solicitor).

A pre-27 September 1989 equitable charge created by the borrower depositing the title deeds with the lender is discharged by the lender returning the deeds.

Deed of release

If the security document creating security over the property contains security over other assets which is being released, a deed of release executed by the lender will be required to release the security over those other assets.

Companies house forms

All forms are available on the Companies House web site. There is no fee for filing them.

Lender's remedies

Legal mortgages

The following are the main remedies for a lender holding a legal mortgage over commercial property to recover the monies secured by that legal mortgage:

- Suing the borrower under the covenant to repay the debt (see **Action on the covenant to pay**).
- Enforcing its security by:

- Taking possession of the property (see **Taking possession**);
- Selling the property (see **Power of sale**);
- Appointing a receiver (see **Appointing a receiver**); or
- Foreclosing (see **Foreclosure**).

Equitable mortgages and charges not made by deed

A lender holding an equitable mortgage or charge not made by deed may sue the borrower under the covenant to pay (see **Action on the covenant to pay**). If a lender holding that type of security wishes to enforce its security it will generally apply to the court for an order for sale of the property or appointment of a receiver, unless express powers have been granted to the lender in the security document allowing it to take these actions without applying to court. Availability of these remedies is subject to general equitable principles.

A lender holding an equitable charge not made by deed does not have the right to foreclose or, in the absence of an express provision in the security document, take possession without a court order.

A lender holding an equitable mortgage not made by deed does not have a power of sale or the right to take possession without, in each case, a court order (assuming there is no express provision in the security document). Such a lender may have the right to foreclose, depending on the circumstances (see **Foreclosure**).

Equitable mortgages and charges made by deed

A lender holding an equitable mortgage or charge made by deed will have a statutory power of sale out of court and a right to appoint a receiver out of court, although the statutory power of sale in the case of equitable security interests may be limited (see **Power of sale**).

If a lender is considering enforcement action, it needs to consider whether there are any overriding restrictions or limitations on it enforcing its security (see **Restrictions on enforcing security**) and the applicable limitation periods (see **Limitation periods**).

If the security over property is contained in a debenture, the lender is likely to be entitled to appoint

an administrator by virtue of being the holder of a qualifying floating charge. In limited circumstances a lender holding a floating charge can still appoint an administrative receiver.

If the security is over leasehold property, additional issues may need to be considered (see **Enforcement issues with security over leasehold property**).

Action on the covenant to pay

The simplest remedy available to a lender is an action in contract on the borrower's covenant to pay (that is, suing the borrower for repayment of the debt). This right to sue the borrower for repayment of the debt survives the lender's exercise of the power of sale, should the lender need to pursue the borrower for any shortfall in the proceeds of sale.

Taking possession

A lender holding a legal mortgage has a right to possession of the property, although this right can be limited by contract or statute.

The Court of Appeal has held that the right to possession of the mortgaged property for a holder of a legal mortgage arises as soon as the mortgage is entered into, unless the mortgage expressly or impliedly excludes that right. Unless specified to the contrary in the security document, the right of possession arises without the need for the secured debt to be payable. However, until the power of sale is exercisable, "the right to possession can only be exercised to protect the security, not as a means of enforcing it".

Unless expressly provided for in a security document, the right to take possession is not available to the holder of an equitable charge over property, and it is only available under an equitable mortgage if it contains an obligation to create a legal mortgage and a contractual right to possession.

A lender becomes a mortgagee in possession either by:

- Taking physical possession of the mortgaged property (if this can be done peaceably). This is rare and usually only takes place where the property has been abandoned.
- Bringing an action for possession.

A lender may need to take possession in certain cases to be certain of selling with vacant possession

(assuming there are no leases binding on the lender).

However, the remedy of possession is very rarely used in relation to commercial properties because of concerns about the duties of mortgagees in possession and the liabilities they may incur, for example, under environmental legislation.

Power of sale

What is a power of sale?

A lender may want to sell the property over which security has been granted and use the proceeds to pay off the secured obligations. Whether a lender can do this or not will depend on whether it has a power of sale, either under express provisions in the security document or under statute. If there is no express or statutory power of sale, a court order will be needed to sell the property.

Statutory power of sale

The statutory power of sale in section 101(1)(i) of the LPA 1925 applies to all mortgages over land (and charges since the term "mortgage" in the LPA 1925 includes a "charge" under section 205 of the LPA 1925) made by deed. It arises when the secured obligations have become due. The sale can be conducted by private treaty or by auction. There is no need to apply to court.

Section 103 of the LPA 1925 governs when the statutory power of sale under section 101 of the LPA 1925 is exercisable. The power of sale can only be exercised if either:

- Notice requiring payment has been served on the borrower and default has been made in making the payment for three months after such notice.
- Two months' interest is unpaid.
- There has been a breach of a provision of the security document other than the payment of principal or any interest thereon.

However, the provisions of section 103 are usually modified or disapplied by a security document to ensure that the lender does not have to wait the time periods specified in that section before exercising its power of sale.

There is doubt as to whether a lender holding an equitable mortgage can convey the legal estate under the statutory power of sale.

Express power of sale under the terms of a security document

A security document will usually grant an express power of sale to the lender, and set out when that power is exercisable. Typically, this is done by stating that the statutory power of sale under section 101 of the LPA 1925 arises on (and is exercisable at any time after) execution of the security document, but that the lender will not exercise its power of sale until the security constituted by the security document has become enforceable. This is likely to be when an event of default has occurred under the related facility agreement. Other statutory provisions that govern the exercise of the power under section 101 of the LPA 1925 are also usually modified or disapplied (see **Statutory power of sale**).

Sale by court order

The court has a discretion under section 91(2) of the LPA 1925 to order a sale, on terms that it thinks fit, on the application of either the borrower or the lender. The courts have used this power to order a sale on the borrower's application in cases where the proposed sale will not clear the debt but delaying a sale would effectively be gambling on a rise in prices.

A lender may purchase the property itself by obtaining a court order under section 91(2) but otherwise the lender may not sell to itself.

Duties of lender when exercising power of sale

A lender exercising the power of sale has various duties, including to act in good faith.

Application of proceeds of sale

When a lender exercises the statutory power of sale under section 101 of the LPA 1925 and there is a surplus from the proceeds of sale, the lender will hold the proceeds on trust to be applied in the following order of priority:

- Discharging prior ranking encumbrances, if the property was sold free of them.
- Paying the expenses of the sale.
- Discharging the secured obligations.

Any surplus is paid to any subsequent security holder or, if there is none, to the borrower.

When a lender exercises a power of sale expressly granted under a security document, that security document will typically set out the order of application of the proceeds of exercising that power.

Effect of exercising power of sale

A sale by a lender holding a legal mortgage under the statutory power, or an express power of sale, transfers title to the purchaser subject to interests having priority to the lender's interests but free of other interests (including the borrower's right to redeem and those of subsequent ranking security holders).

A sale by a lender, by deed, under its statutory power of sale, overreaches:

- Subsequent mortgages and charges (section 104, LPA 1925).
- The borrower's interest (section 2(1)(iii), LPA 1925).

Appointing a receiver

A lender holding a legal mortgage or other fixed charge or security interest is usually able to appoint a receiver under one of the following:

- Express powers contained in the security document.
- Statutory powers.

The purpose of appointing a receiver is for the receiver to take charge of the assets, to realise them (usually by a sale to a third-party purchaser) and use the realisation proceeds to repay the monies due to the appointing lender from the borrower.

A security document will almost always contain an express power for the lender to appoint a receiver. This type of receiver is usually referred to as a "fixed charge receiver".

However, if a security document does not contain an express power to appoint a receiver, and the security created is a mortgage made by deed, then the lender can appoint a receiver of the income of the asset under the statutory powers contained in section 101 of the LPA 1925. This type of receiver is referred to as a "Law of Property Act receiver" (LPA receiver).

A lender can also apply to the court to appoint a receiver under section 37 of the Senior Courts Act 1981, although this power is not commonly used. The

court may appoint a receiver if it considers it “just and convenient to do so”.

If a receiver is appointed under the express powers in a security document, when that appointment can be made will depend on the terms of the security document. Usually, a security document will provide that the lender can appoint a receiver at any time after the security constituted by the security document has become enforceable (for example, following an event of default under a related facility agreement).

The power to appoint a receiver under section 101 of the LPA 1925 arises when the secured obligations have become due, and it becomes exercisable at the same time that the statutory power of sale becomes exercisable (section 109, LPA 1925). For the statutory power of sale to arise, the monies secured by the security document must have become due, and the power of sale will only become exercisable if the conditions set out in section 103 of the LPA 1925 have been satisfied (see **Statutory power of sale**).

The security document will typically include an express power to appoint a receiver that extends the statutory powers of appointment and the powers of the receiver itself, in particular by:

- Conferring a power of sale on the receiver.
- Allowing appointment whether or not the property produces an income.
- Providing that the power becomes exercisable as soon as it has arisen.

In respect of property, receivers are generally surveyors and they do not have to be insolvency practitioners.

Foreclosure

Where a mortgage is granted over property, the borrower retains the equity of redemption. Foreclosure is the process by which the borrower’s rights in the property are extinguished (that is, the borrower’s equity of redemption is extinguished) and that property becomes vested in the lender. The lender becomes the absolute owner of the property and may then sell it free of the borrower’s rights (including its equity of redemption), and free of the rights of any lower ranking security holders.

Foreclosure is a remedy available to the holder of:

- A legal mortgage.

- An equitable mortgage, if that equitable mortgage contains an agreement to create a legal mortgage and the property over which the mortgage is created is capable of being subject to a legal mortgage.

Foreclosure is not available to the holder of:

- A charge.
- An equitable mortgage that cannot be turned into a legal mortgage.

A lender’s right to foreclose arises once the obligations secured by the mortgage have become repayable.

Foreclosure is now rarely used in practice.

Restrictions on enforcing security

The lender and its lawyers should check whether there are any overriding restrictions or limitations on the lender enforcing its security. For example:

- There may be intercreditor arrangements in place that govern enforcement of the security.
- If the borrower’s liabilities are being restructured and there is a standstill agreement in place this is likely to restrict enforcement of security for a specified period of time.
- If the borrower is in administration, then its assets will be subject to a moratorium and the lender will be unable to enforce its security over property.
- Under the Insolvency Act 1986, a liquidator and an administrator can, in certain circumstances, challenge security arrangements and have them set aside, meaning that that security will be unenforceable. Transactions which are reviewable in this way include security arrangements that constitute a:
 - Preference; or
 - Transaction at an undervalue.

Limitation periods

The limitation period for the enforcement of a debt secured by a mortgage or charge over property is governed by section 20 of the Limitation Act 1980. In relation to:

- Principal it is 12 years from the date the cause of action accrued.
- Interest it is six years from the date the interest

became due.

Enforcement issues with security over lease: hold property

Forfeiture of the lease

A landlord's rights of forfeiture (notwithstanding that they are limited by various statutory rules) put the value of the tenant's lender's security at risk. A lease provision that allows the landlord to forfeit the lease on the tenant's insolvency will generally make a lease with a capital value unacceptable as sole specific security. A landlord will often also have a right to forfeit on breach of covenant by the tenant. If the tenant's lender has a legal mortgage (or an equitable mortgage accompanied by a right for the lender to call for a legal mortgage) it can apply for relief from forfeiture (sections 87(1) and 146(4), LPA 1925). The holder of an equitable charge does not have a direct right to apply for relief, but may obtain relief indirectly by joining in the tenant's application.

Even with its rights under section 146(4), there are weaknesses in the tenant's lender's position.

Transfer of mortgages and sub-mortgages

Transfers

A lender is, in general, entitled to transfer a mortgage granted in its favour without the consent of the borrower.

A transfer of a legal mortgage must be by deed (section 52(1), LPA 1925). A transfer of an equitable mortgage must be in writing (section 53(1), LPA 1925).

If the land is registered, the proprietor of a registered legal mortgage will (in favour of a disponee) have power to transfer that legal mortgage unless there is a restriction to the contrary on the register (sections 23 and 26, LRA 2002).

A transfer of a registered legal mortgage must be in form TR4 and must be completed by registration of the transferee as proprietor of the charge.

Sub-mortgages

A sub-mortgage is a mortgage of a mortgage; in economic terms the (head) lender charges the debt

and interest stream receivable under the (head) mortgage in favour of the sub-mortgagee:

- A sub-mortgage may also be used in respect of part only of the debt.
- Sub-mortgages can be used as the legal basis of securitisations of portfolios of residential mortgages.

In registered land, a sub-mortgage may only be effected by way of sub-charge of the indebtedness secured by the (head) mortgage; other forms of sub-mortgages (for example, a sub-mortgage by sub-demise) are precluded (section 23(2) and (3), LRA 2002). The sub-charge must be registered in the charges register in order to take effect as a legal sub-charge (sub-charge certificates will not be issued) (section 59(3) and paragraph 11, Schedule 2, LRA 2002).

Regulation of mortgages

Financial Services and Markets Act 2000

The Financial Services and Markets Act 2000 (FSMA) (as amended by the Financial Services Act 2012) regulates the following through the Financial Conduct Authority (FCA):

- Regulated mortgage contracts (RMCs) (these are essentially first-ranking legal mortgages on land securing credit to an individual or trustees where at least 40% of the land is, or is intended to be, used as or in connection with a dwelling by the borrower).
- Home reversion plans (HRPs) (equity release products that involve sale and lease arrangements).
- Home purchase plans (HPPs) (also equity release products that involve sale and lease arrangements).

It is not just lending and administration relating to RMCs, HRPs and HPPs that the FCA regulates. The FCA also regulates arranging and advising on these products.

Anyone carrying on any of the activities relating to these regulated products that fall within the scope of FSMA must be authorised to do so by the FCA. They must comply with rules and principles in the FCA's

Handbook, that cover all aspects of a firm's business, from interaction with customers and potential customers, to financial requirements and the systems and controls in place to ensure compliance. The main FCA rules that dictate how firms carrying on regulated business relating to these products should interact with customers and potential customers are found in the Mortgages and Home Finance: Conduct of Business sourcebook (known as MCOB).

Financial crimes

The UK financial crime regime includes laws, regulations and rules relating to money laundering (which involves concealing the identity of illegally obtained money so that it appears to have come from a lawful source) and terrorist financing. The key offences in the UK are contained in the following:

- The Proceeds of Crime Act 2002 (POCA).
- The Terrorism Act 2000 (TACT).
- The UK financial sanctions regime, which is implemented and administered by HM Treasury.
- The Money Laundering Regulations 2007 (SI 2007/2157), as amended by the Money Laundering (Amendment) Regulations 2012 (SI 2012/2298).

Among other things, firms in the mortgage sector are also expected to take steps to prevent and detect mortgage fraud. On 1 September 2011, the Building Societies Association in conjunction with the Council of Mortgage Lenders and HM Revenue & Customs launched a new mortgage verification scheme to combat mortgage application fraud.

The requirements of the UK financial crime regime are not confined to banks. Law firms and other financial institutions are liable to comply with the requirements.

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