LEARNING OUTCOME 3

EXPLAIN THE LEGAL PRINCIPLES APPLICABLE TO MORTGAGES AND APPLY THOSE PRINCIPLES TO CASE STUDY SITUATIONS

3.1 EXPLAIN THE CHARACTERISTICS OF MORTGAGES UNDER THE GENERAL LAW SYSTEM AND INDICATE THE RIGHTS OF MORTGAGORS AND MORTGAGEES

See 3.2

3.2 EXPLAIN THE CHARACTERISTICS OF MORTGAGES UNDER THE TORRENS SYSTEM AND GIVEN CASE STUDIES, IDENTIFY THE RIGHTS AND DUTIES OF MORTGAGEES AND MORTGAGORS.

Read Lang: Chapter 23 *Mortgages*

ENCUMBRANCES, MORTGAGES & CHARGES: In a broad sense an *encumbrance* includes a mortgage or charge. However in practice, "encumbrance" means a charge on the land to secure the payment of an annuity or sum of money other than debt. An encumbrance is created on the registration of a *Memorandum of Encumbrance* for land under the Torrens system. It is discharged in a similar manner to that for a mortgage.

MORTGAGE: A mortgage is a charge made merely to secure a debt. A charge is usually a "statutory encumbrance" that makes certain rates, taxes and expenses to which land becomes subject by state (for example, land tax) and local authorities (for example, rates). It is defined in the RPA as any "charge on land created merely for securing a debt" (s6 RPA). The necessary procedure for the registration of a mortgage is covered in Division 3 - Mortgages and Encumbrances - sections 92 to 103 of the RPA.

Land can be used for security for the payment of a sum of money. The lender can execute a mortgage of the land or he/she may hand over the Certificate of Title of the land. Mortgages vary depending upon whether they are *legal* or *equitable*.

LEGAL MORTGAGES: Under the Torrens System a *legal mortgage* is one effected by the registration of a duly executed *Memorandum of Mortgage* in the form prescribed by the Act. A mortgage is a contract between the lender (mortgagee), and the borrower(mortgagor) whereby the property becomes security for money owing, lent, or some performance of value. It becomes a charge over the real estate. Because land cannot be destroyed and is fixed, it is good security (collateral) for borrowed money. Further, the charge over land has priority against other creditors of the mortgagor and the first mortgagee has priority over the second mortgage. The disadvantage of real estate as security is its illiquid nature, however, a mortgagor can transfer his interest by registered transfer subject to the mortgage.

Under the Torrens system a mortgage is a statutory charge or security only and is not a transfer of land. That is, unlike old system title, the property remains in the name of the mortgagor. The mortgage confers an interest but no estate and the mortgage charge is created upon registration of the mortgage on the Certificate of Title. The see relevant sections in the Real Property Act are in Division 3, sections 92 to 103.

MORTGAGE COVENANTS: The covenants in a mortgage contract can be either implied, express, or statutory. Express covenants are those clearly stated in the mortgage document, implied covenants are those which are assumed from the interpretation of the express covenants (that is, the express clause is not clear), and statutory covenants are those contained in the RPA (Part XI - Implied Covenants and Short Forms of Covenants - sections 109 to 123).

CLOGS ON THE EQUITY OF REDEMPTION: Follows the principle in equity, "once a mortgage, always a mortgage". Equity will not allow a mortgage to be used for other purposes. For example, a mortgage cannot be made irredeemable on a certain event. Such a fetter on the equity of redemption is known as a clog.

MORTGAGEE'S POWERS: The mortgagee's powers are:

- To sue for the money owing
- To sell but the mortgagee must have a court order (s94 RPA)
- Entry and possession (s96)
- To foreclose (s97).

EQUITY OF REDEMPTION: Under the RPA a mortgage of either freehold or leasehold is effected by execution in duplicate and registration of a "Memorandum of Mortgage". This does not transfer land or any estate in it to the lender but is a "statutory charge" in his/her favour. Since there is no alienation of the legal estate there is technically, no equity of redemption.

SALE: This is the most important and common method of remedy by the mortgagee. Upon default the mortgagee usually has the power to sell the legal estate free from the Equity of Redemption. The power of sale is a statutory one. After notice, the mortgagee may sell the land and exercise a transfer which upon registration vests the estate of the mortgagor in the purchaser freed from the mortgage. The purchase money received is to be allocated as follows:

- Crown charges eg unpaid land tax
- Expenses of sale
- Money owing to the vendor-mortgagee
- Monies owing to subsequent mortgagees in order of priority
- Any surplus to the mortgagor.

There is generally, an express Power of Sale in the equitable mortgage. The purchaser having the whole equitable estate could require the registered proprietor of the legal estate to convey it to him.

ENTRY: This again is not a popular remedy because of the strictness of equity. It is a right to enter and take possession *of the land* to receive the rents & profits.

FORECLOSURE: In practice, foreclosure is not a suitable remedy as generally, it gives the mortgagee an estate he/she does not want as he/her prime occupation is as a lender and not property manager. Therefore, it is only used as a last resort. It is more likely to be used where the debt exceeds the amount that could be realized on sale, the mortgagee hoping for capital gains in the near future.

RECEIVER: As the name implies a receiver is a person with only the right to receiving the rents & profits and is an agent of the mortgagor. It overcomes the strict account that is required of the "mortgagee in possession" as the mortgagee is under no personal liability for his acts or omissions.

DUTY OF GOOD FAITH: The mortgagee cannot sacrifice the mortgagor's interest. He is entitled to look after his own interest and assuming he takes obvious precautions to ensure a fair price, is not liable.

SECOND AND SUBSEQUENT MORTGAGES: The mortgagor can create 2nd and subsequent mortgages on the security of equity of redemption. For Torrens land a second or subsequent mortgage is a statutory legal charge but subject to the rights of prior mortgagees.

MORTGAGE DISCHARGE

The discharge of a mortgage agreement can be summarized as follows:

- **TORRENS:** A mortgage over Torrens land is discharged by registration of the Memorandum of Discharge and upon registration, the interest of the mortgagee ceases.

- **EQUITABLE:** Requires the receipt or some other satisfactory evidence of payment sufficient to discharge the mortgage.

CHARGES: A charge is usually a statutory encumbrance for certain rates, taxes and expenses on land and made by the State and Local Authorities. They become a first charge on the land. The Government has priority over mortgages and other encumbrances.

MORTGAGE INSURANCE: When a mortgage is taken over a strata lot the proprietor should take out mortgage insurance. In the case of destruction or damage by fire the insurer will pay out the mortgagee and the insurance company becomes the new mortgagee. Mortgage insurance is generally required where the borrower is borrowing more than 75% of valuation. The policy protects the lender in case the borrower defaults and the property on resale would realise less than the balance of moneys owing. The premium is a once only payment and is sometimes added to the loan. The cost will vary with the ratio of loan to valuation.

MEMORANDUM OF MORTGAGE: The term mortgage in this Jurisdiction is defined as an instrument that creates a charge on land to secure the repayment of a debt. In the ACT a mortgage does not operate as a transfer of the legal estate however it does confer upon a mortgagee the power of sale in respect of certain breaches of covenant. In the ACT a mortgage will only operate as a transfer if it is specifically drafted in that manner. Any number of Mortgages may be registered however their respective priorities are determined at time of lodgment and subsequent registration.

Priority confers the right on an earlier mortgagee more beneficial rights as to:

- repayment of monies under power of sale
- right of approval of subsequent mortgagees
- priority of payment when sale is effected by a later mortgagee.

A Mortgage may be varied in terms of its term, interest rate or principal sum. The priorities of mortgagees may also be varied by consent of all mortgagees. Upon repayment, a Discharge of Mortgage is normally registered.

3.3 EXPLAIN THE CHARACTERISTICS OF EQUITABLE MORTGAGES AND IDENTIFY THE RIGHTS OF MORTGAGEES AND MORTGAGORS.

See also 3.2

EQUITABLE MORTGAGE: An unregistered mortgage can be enforced as an Equitable Mortgage by way of *specific performance*. They are arrangements where generally, the land becomes charged with the payment of money. It can be enforced at equity even though not a legal mortgage. The mortgage money is an *equitable charge* on the land whereas a legal mortgage under the RPA is a *legal charge* on the land.

There must be an agreement to create a legal mortgage (that is, one that creates an interest in the land). The agreement may be implied for example, from the deposit of title deeds by way of security. When the Certificate of Title is handed over as a security for the repayment of a loan the mortgage is an equitable one and there is no conveyance of the legal estate (that is, it is not a legal mortgage).

EXAMPLE: A borrower or debtor agrees to a simple contract that states that he/she charges his/her land with the repayment of $X. This is an *equitable mortgage* as a legal interest has not been created.