



# DAVIS LAWYERS

## Legal Insights

### CONSIDERATIONS FOR A MORTGAGEE ENTERING INTO POSSESSION OF PROPERTY

If a borrower is in default under a loan facility and the lender has the benefit of a registered (but not unregistered) mortgage over real property, at any time after the default occurs, the lender / mortgagee has a right to enter possession of the property. Usually, the mortgagee will have issued a default notice earlier and given the borrower a warning that if the default is not remedied, other action may follow. It is not actually necessary to issue a default notice for loans not covered by the *National Credit Code*.

Lenders should be aware of the distinction between:

1. entering possession of a property; and
2. exercising power of sale.

These 2 concepts are interwoven, but often occur independently. This paper discusses the concept of entering possession of a property, which is usually the first step in the process, because, practically speaking, it is difficult to exercise power of sale before possession is obtained. For instance, if possession is not obtained, the mortgagee may not be able to conduct inspections of the mortgage property with potential buyers.

There are other reasons a mortgagee may wish to enter possession other than in relation to a mortgagee sale. For instance, to preserve the value or security of the mortgage property.

With this in mind, the following issues are addressed below:

1. How to enter possession
2. Risk of the property
3. Enforcing a mortgage over a part-share in land
4. Improvements and repairs
5. Statutory liabilities
6. Employing agents

### 1. How to enter possession

A mortgagee may enter possession in a number of ways. They include:

- If a property is not physically occupied by anyone - in relation to vacant land, this means merely giving a notice of entry into possession. In the case of a property which has an unoccupied vacant building on it, once again, entry in possession can be by giving a notice and/or taking other unequivocal acts to make it clear the mortgagee has possession of the property (eg., erecting a fence or changing locks). In exercising this self-help remedy, a mortgagee must be careful not to contravene any applicable criminal law of the State. This is a dangerous process if the premises are occupied, because if the occupiers resist, the mortgagee may end up inadvertently committing crimes such as forcible entry or assault, and the courts dimly view attempts to take possession through any form of force. If, however, the security property is vacant land, taking possession by self help is relatively risk-free and is likely to be the best course. Self help is open to a registered mortgagee but not an unregistered mortgagee. Caveat lenders will therefore need to convert their mortgage to a registered mortgage or will require a Court order.
- If a property is tenanted, the mortgagee can enter possession by "receipt of the rents and profits". In practice, this means giving the tenant and managing agent a notice that the mortgagee has entered possession and requiring the tenant / managing agent to pay rent to the mortgagee. The mortgagee in this case should be aware that if it requires the tenant to pay rents to it under the lease, the mortgagee may be adopting the lease and hence bound by its terms, which in that case, it cannot later eject the tenant, otherwise than in accordance with general tenancy law. If the mortgagee is not bound by the lease, then it can take Court action to eject the tenant.
- Obtaining a court order for possession. This may be necessary if, for instance, a property is occupied (either by an owner, builder or a tenant) and the occupier refuses to vacate after a demand for possession is made. In the worst case, obtaining the order and then having the bailiff remove an occupier may take upwards of 6 months.

In the case of occupied property, a mortgagee needs to establish whether the occupier has a prior interest in the property which is superior to the mortgagee (eg., if the lease was in place before the mortgage was registered). In that case, the mortgagee's interest in the property is subject to the prior interest and the mortgagee must respect the tenant's interest in the property. A mortgagee sale in that case would be subject to the tenancy.

### 2. Risk of the property

Once a mortgagee enters possession, a number of duties and liabilities are imposed on the mortgagee and it assumes risk of the property. Generally speaking, a mortgagee in possession can be thought of as an owner and should act accordingly.

As a mortgagee will find it difficult to be sure of the status of the owner's policy, the prudent course of action is for the mortgagee to insure the property (unless the property is part of the community or strata title complex). The mortgagee must also make sure the property is protected from vandalism or other damage. In some, cases this may require the mortgagee to erect a temporary fence and/or employ security guards or patrols. The mortgagee is entitled to recover these costs from the borrower/mortgagor.

### 3. Enforcing a mortgage over a part-share in land

A mortgagee who has a mortgage over a part-share in land (for example over the interest of only one of two joint tenants or tenants in common) cannot enforce its mortgage by the usual means of possession or judicial sale proceedings, but should instead make an application for the appointment of trustees for sale of the property. The mortgagee can make such an application because the mortgagee of a co-owner's share in land is viewed as a co-owner of that land.

### 4. Improvements and repairs

There is no general obligation on a mortgagee to make improvements to the property before sale (eg., complete repaint of the exterior of a house). This is the case, even if a prudent owner might risk a substantial outlay in order to secure a possibly higher price.

However, if some expenditure is reasonable in the circumstances and apparently necessary and prudent to preserve the mortgagor's interest and to prevent their interests being sacrificed, especially where the amount to be spent would be consistent with the total selling value, then the mortgagee would be expected to spend the funds.

Having said that, there are some forms of spending which may be regarded as usual. For example, usual repairs to (eg broken windows) and maintenance of the building, cleaning and garden maintenance, repairs to pool equipment. If a property could not be legally sold without a pool fence, then it may well be appropriate for the mortgagee to expend funds to have one constructed or to spend a modest amount on removing a termite infestation.

### 5. **Statutory liabilities**

A mortgagee should be aware that entering possession of property triggers some statutory liability, such as land tax and liability for contamination. These risks should be assessed before the decision is made to enter possession.

### 6. **Employing agents**

In relation to duties owed to a mortgagor, it is not sufficient for a mortgagee to blindly rely upon third parties for assistance. It has been held that if an agent or consultant fails to meet the standard applicable to the mortgagee when undertaking action, the mortgagee will remain liable, but may have a separate claim against the negligence consultant / agent.

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