



Commercial notes

Number 33 | 9 November 2009

SECURITIES: ENSURING PAYMENT OF DEBTS TO THE COMMONWEALTH

In this note we consider the ways that Commonwealth departments, agencies and authorities can obtain security for the payment of debts. Our discussion will focus on mortgages and charges in particular.

Many agencies become involved in some way with the collection of debts. These debts can arise in a variety of circumstances and occur most commonly in the following types of payments:

- taxes, duties or other statutory levies
- legislative penalties and fines
- overpayment of Commonwealth statutory benefits or entitlements
- recovery of grant moneys that have not been used for the purpose of the grant
- statutory and other loan schemes.

In some cases, the payment or repayment of moneys owed to agencies is secured by a *statutory security interest* (for example, the charge created under s 1138 of the *Social Security Act 1991* for the pension loans scheme). In other cases, however, agencies can safeguard the financial interests of the Commonwealth by obtaining *security* for the payment of the moneys owed.

What types of property can be used as security?

Securities can be obtained over many types of property, including:

- real property (land and the buildings located upon it)
- interests in real property (for example, a lease, mortgage or other recognised interest in land held by the debtor)
- goods, often referred to in the securities context as ‘chattels’ (for example, motor vehicles)
- other types of assets (for example, moneys on deposit and shares)
- ‘choses in action’ (for example, the right to make a monetary claim at law)
- rights arising under copyright and other intellectual property interests.



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Should security be taken?

Where the payment of moneys owed to agencies is protected by a statutory security interest, this will normally¹ be sufficient to ensure payment of the debt. However, where the debt is *not* protected by a statutory security interest, agencies should consider whether to obtain a security from the debtor to ensure payment of the debt. In these circumstances, the debtor's consent to the grant of a security *will be needed*.

Typically, the debtor will grant a security in exchange for an agency's promise that it will defer debt recovery action or that it will not exercise any relevant statutory powers. The debtor and the agency may make a payment arrangement at this time.

What type of security should be taken?

If the debtor has agreed to grant security to an agency, the decision about the type of security the agency should obtain will be influenced by a number of factors, including:

- the nature of the debtor's ownership of the property and the nature of the property interest
- the nature and extent of any existing security interest over that property
- whether any consent must be obtained or any other precondition must be satisfied before the debtor may grant a valid and effective security interest to an agency
- the amount of equity available in the property after any other superior security interests have been taken into account
- the costs associated with the creation of the applicable form of security (including stamp duty, registration fees and legal fees).

In this discussion² we look at the two most common types of security for the most commonly held form of property: mortgages and charges over real property. We also explore some of the things that agencies will need to take into account when deciding which type of security is most appropriate for their circumstances. (Please note that our discussion relates only to land registered under the Torrens system ('registered land'). Different considerations and procedures will apply to securities for land under general law (non-Torrens-system land).)

Registered mortgage

Mortgages may be created in several different ways; however, in this article we focus on the *registered mortgage*: a mortgage which is expressly created by written agreement between an agency (the mortgagee) and the debtor (the mortgagor), and registered with the titles registration office in the relevant state or territory. Where a mortgage is registered over registered land, it is recorded as an encumbrance on the title of the land until it is discharged.

Equitable charge

An alternative form of security to the registered mortgage is the *equitable charge over real property* ('equitable charge'). This security, which is an

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equitable interest, is generally created by agreement between the parties.³ In contrast to the registered mortgage, the equitable charge over real property is not generally registrable.⁴

However, the party in whose favour the equitable charge has been granted (i.e. the chargee) may lodge a *caveat* over the title of the land to which the equitable charge relates, to notify others of its interest in the land.

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How do registered mortgages and equitable charges provide protection for agencies?

Registered mortgages and equitable charges provide protection for a proprietary interest in two main ways:

- First, each security ensures that the creditor (i.e. an agency) has access to *remedies* in the event that the debtor fails to pay or repay the debt (or any part of it) on time
- Second, each security gives the creditor certain *rights* (to varying degrees) against other persons claiming an interest in the land (including the debtor).

What legal remedies are available to agencies with security over property?

Registered mortgage

The mortgagee under a registered mortgage has a number of remedies available to it. If the mortgagor is in default of the mortgage, the mortgagee may sell the land or exercise other rights in relation to the property,⁵ enter into possession (or receive any relevant rents and profits from the property rather than selling it), or appoint a receiver.

Registered mortgagees also enjoy rights provided in the statute governing the creation of the registered mortgage (for example, the power of sale) that are not available under an equitable charge. Such rights may be exercised without the mortgagee (agency) needing to obtain court orders or undertake other steps before enforcing its security.

A registered mortgage can also be drafted to give powers to the mortgagee aimed at preserving the integrity and value of the secured property—for example, an agency as mortgagee could be entitled to vet any alterations or additions that the debtor may make to buildings on the property.

Equitable charge

If it has been created in the proper form, an equitable charge may entitle agencies to remedies similar to those for a mortgage, although the remedies of foreclosure and entry into possession are not available. The absence of the remedy of foreclosure, however, may not be significant, as the procedural requirements for this remedy are cumbersome, so it is rarely used.

A more significant limitation of this security is that, unlike a registered mortgage, the remedies are not conferred by statute and can only be exercised by order of a court. An equitable chargee cannot, therefore, take possession

of the land upon default unless the original agreement between the parties entitles the equitable chargee to do so, in which case no court order is required. Although an equitable charge may entitle the equitable chargee (i.e. the agency) to sell the land, the equitable chargee must first obtain appropriate court orders (as noted above).

An equitable charge can also be drafted to give powers to the equitable chargee aimed at preserving the integrity and value of the secured property—for example, an agency as an equitable chargee could be entitled to vet any alterations or additions that the debtor may make to buildings on the property if this is specified in the charge agreement.

What rights are provided to agencies with security over property?

Except for a few important differences outlined above, the remedies that registered mortgages and equitable charges can offer are fairly similar. However, the rights that each type of security provides against the competing interests of third parties are starkly different. The difference lies in the extent to which the registered mortgage and the equitable charge allow an agency's interest to take *priority* over the interests held by other parties in the property. This goes to the strength of the security from the agency's perspective.

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The way priorities are applied can be seen in the example of a property that is encumbered by several mortgages or charges. If the secured land is sold, the proceeds of sale will be distributed to each interest holder (that is, mortgagee and chargee) in order of the priority of their interest. If an agency has an equitable charge, subject to our comments below, it would only be entitled to whatever remained *after* superior interests (such as a registered mortgage) have taken their share. The residue that the agency would be entitled to might not be sufficient to discharge the debt owed. Indeed, there may be no residue.

The legal principles of priorities are complex; however, in general terms, as far as the equitable charge and registered mortgage are concerned, the following principles are relevant:

- registered interests take priority over unregistered interests
- among registered interests, the priority will usually be in order of the date of registration—this means that the strongest security is the first registered mortgage
- all other things being equal, the priority between unregistered equitable interests (such as an equitable charge) will usually be in order of their time of creation (see our comments below).

Registered mortgage

A *registered mortgage* would usually ensure⁶ that an agency's interest as mortgagee takes priority over all unregistered interests and any subsequent registered interests. This means that, if the property is sold and an agency has a first registered mortgage, the amount owing under the mortgage will usually⁷ be paid out of the proceeds of sale before any other debts are paid (or, where the debtor dies, the outstanding amount may be paid out of the estate

before other debts are paid). This is particularly significant where the same property is encumbered by multiple charges or mortgages.

Equitable charge supported by a caveat

An equitable charge creates an equitable interest in land. This means that, when compared with a *registered mortgage*, an equitable charge, even one supported by caveat, is weaker because a registered mortgage creates a legal interest in land, whereas a charge (other than the limited class referred to earlier⁸) creates an *equitable* interest in the land. This also means that if there was a competition between two unregistered interests in land (that is, between two equitable interests in land), each of which was supported by a caveat, the first in time will usually prevail, all other things being equal. For example, if there was a competition between:

- a person claiming an interest in land under a charge supported by a caveat and
- a second person claiming an interest in the same land under a later unregistered mortgage supported by a later caveat,

the interest of the first person would normally take precedence over the later unregistered mortgage.

Subject to our comments below, similarly, any registered dealings, whether created before or after the equitable charge, would also take precedence or priority over the equitable charge even if its existence is notified by caveat. For example, if the land was subsequently mortgaged and that mortgage was registered then the registered mortgage would take priority over the previous equitable caveated charge.

Although the equitable charge is regarded as an equitable interest, the ability to lodge a caveat to protect that interest provides, in practical terms, a strategic benefit to an equitable chargee.

The caveat is a means of notifying a claim to an unregistered interest. If a caveat has been lodged, it will (subject to the terms of the caveat) operate to prevent registration of most dealings with the property.⁹ A person seeking to register a subsequent interest can take steps to challenge the caveat or enter into negotiations with the caveator to facilitate the registration of that party's dealing, including arrangements to re-arrange the respective priorities of competing interests in the property.

For example, where an agency holds an equitable charge that has been caveated, the existence of the caveat means that the agency will either be notified by the state land registry of any dealings lodged for registration after that caveat or contacted by the person seeking to register an interest in the land. The agency's consent (as chargee/caveator) to the registration of the subsequent dealing will be required¹⁰ (unless the caveat expressly permits registration of subsequent interests). While this does not offer any remedial protection, agencies can ensure that their interest in the property is protected because their consent is needed prior to any dealings subsequent to the registration of the caveat.

When compared with a registered mortgage, a charge supported by caveat is weaker ...

Agencies as equitable chargees then have a strategic benefit in their dealings with the agency's debtor and subsequent mortgagee. The agency could, for example, agree to provide its consent to the registration of the subsequent mortgage on certain conditions, such as that the agency debt be paid out from funds to be advanced by the proposed subsequent mortgagee¹¹ or that the agency and the mortgagee enter into a priority agreement¹² which will ensure that the agency receives payment of its debt ahead of the mortgage debt. Alternatively, the agency may agree to other arrangements regarding the order of distribution of any money derived from the sale of the property.

Registered mortgage v equitable charge: which form of security is preferable?

When considering which type of security is desirable in the circumstances, agencies should balance the level of protection each form of security gives them against the administrative cost of creating of the security.

The administrative costs involved in finalising a registered mortgage are often greater than those for creating an equitable charge.

Agencies also need to consider the likelihood of being able to get debtors to agree to granting an equitable charge as opposed to a registered mortgage. Experience suggests that it is often more difficult to get a debtor to agree to grant a registered mortgage as opposed to an equitable charge—a hurdle which can delay the creation of the security.

Also, the procedural requirements for creating a registered mortgage can be fairly burdensome. For example, where a prior registered mortgage exists, the prior registered mortgagee must consent to an agency's mortgage. In some jurisdictions, the instrument of title held by the prior registered mortgagee will need to be made available at the local land registry so that an agency's mortgage can be registered. This will add to the cost of taking out the security for either the agency or the debtor.

Agencies will need to consider these factors when deciding on the most appropriate and useful form of security in the particular circumstances of each case.

Variations in procedure between states and territories

It is important for agencies to keep in mind that the procedure for creating securities can vary quite significantly between states and territories. Some of the salient differences are shown in the table on pp 8–9.

It must also be borne in mind that each state and territory generally has different fees for stamping and registration of mortgages and lodgement of caveats, although usually the amount of the duty will relate in some way to the amount of the debt secured.

Lands Acquisition Act approval

If an agency is subject to the *Lands Acquisition Act 1989* (LAA), it should be borne in mind that, while the grant of a charge or mortgage in favour of an agency will constitute an acquisition of an interest in land, s 21(1) of the LAA makes it clear that:

Agencies should balance the level of protection each form of security gives them against the administrative cost of creating of the security.

An acquiring authority shall not acquire an interest in land otherwise than in accordance with this Act unless ...

(d) the acquisition consists of the taking of a mortgage, charge or other similar security over an interest in land.

In short, the process for acquisition of an interest in land, including the need for approvals under the LAA, does not apply to the taking of mortgages or equitable charges.

Conclusion

Securities can be a useful and powerful tool in the recovery of debts or other moneys payable to agencies and they can safeguard the financial interests of an agency. Securities can be obtained over a range of properties. The form of security an agency takes will be influenced by a number of factors, such as the nature of the debtor's ownership of the property; the nature of the property interest; and, importantly, the amount of equity or value left in the property after other superior security interests are taken into account.

AGS can help agencies to decide whether to take securities and what form of security might be suitable for their needs. We can also help with the preparation of necessary legal documentation.

Table of jurisdictional differences

<i>State/territory</i>	<i>Legislation</i>	<i>Caveat requirements</i>	<i>Comments</i>
Australian Capital Territory	<i>Land Titles Act 1925</i>	<p>The caveator must have an ‘interest in the land’ over which caveat is sought. While ‘interest’ is not defined in the legislation, a Deed of Charge (which specifically charged the land with the debt in favour of the Commonwealth) would be sufficient.</p> <p>The caveator must make a statutory declaration that they have a caveatable interest in the property.</p> <p>The caveat form comprises a statutory declaration as to the information contained in the caveat lodgement form. A separate statutory declaration is not therefore required to be lodged with the caveat form at the time of lodgement.</p>	
Northern Territory	<i>Land Title Act 2000</i>	<p>A caveat can be lodged at any time by any person claiming to have an interest, at law or in equity, whether under an agreement, unregistered instrument or otherwise, in any land.</p> <p>The caveat must be signed and lodged by the caveator, or his or her agent. It can be lodged without the knowledge of the registered proprietor of the land.</p> <p>A statutory declaration is not required for the lodgement of routine caveats. However, in some cases statutory declarations may be required by the Land Registry to be provided by the caveator to substantiate the basis of the caveat.</p>	Note that all land in the Northern Territory is Torrens title.
New South Wales	<i>Real Property Act 1900</i>	<p>The caveator must claim a legal or equitable interest in the land (commonly referred to as a ‘caveatable interest’), and must identify with particularity the quantum and nature of the caveatable interest. The solicitor executing the caveat must make a statutory declaration that the caveator has a legal or equitable interest in the land.</p> <p>If the agency has entered into a Deed of Charge with a debtor, and the debtor grants the agency a fixed charge in relation to the debtor’s land, then that interest will qualify as a caveatable interest.</p> <p>The caveat form comprises a statutory declaration as to the information contained in the caveat lodgement form. A separate statutory declaration is not therefore required to be lodged with the caveat form at the time of lodgement.</p>	<p>A caveat which purports to protect an interest under an unregistered mortgage or under a charge cannot be registered unless it is stamped.</p> <p>Normally, such a caveat is stamped collateral to the security document, but it need not be, as the caveat itself may be stamped with the primary duty.</p>
Victoria	<i>Transfer of Land Act 1958</i>	<p>A caveat may be absolute or permissive. Once a caveat has been withdrawn, it cannot be re-lodged in relation to the same matter.</p> <p>A statutory declaration is not required for the lodgement of routine caveats. However, in some cases statutory declarations may be required by the Land Registry to be provided by the caveator to substantiate the basis of the caveat.</p>	

State/ territory	Legislation	Caveat requirements	Comments
Queensland	<i>Land Title Act 1994</i>	<p>Under the <i>Land Title Act 1994</i> (Qld), a caveat will lapse unless the caveator commences proceedings to support the caveat within 90 days of its registration. The Registrar must be notified of the commencement of those proceedings.</p> <p>However, if the consent of the registered owner of the property is obtained and deposited then the caveat is non-lapsing.</p> <p>When a caveat has lapsed, a caveator cannot lodge a further caveat based on the same or substantially the same grounds as those stated in the original caveat unless the leave of the Court is granted.</p> <p>In these circumstances, charges supported by caveats are not a practical means of protecting Commonwealth interests. Accordingly, it is recommended that, in Queensland, debts are secured by registered mortgages.</p> <p>A statutory declaration is not required for the lodgement of routine caveats. However, in some cases statutory declarations may be required by the Land Registry to be provided by the caveator to substantiate the basis of the caveat.</p>	<p>A charge may be registered on title pursuant to a Form 14 General Request. The debtor must agree in writing to the property being charged to secure the debt. There is no practical advantage to pursuing this option over a registered mortgage.</p>
South Australia	<i>Real Property Act 1886</i>	<p>A caveat may be absolute or permissive. Once a caveat has been withdrawn, it cannot be re-lodged in relation to the same matter.</p> <p>The caveat form comprises a statutory declaration as to the information contained in the caveat lodgement form. A separate statutory declaration is not therefore required to be lodged with the caveat form at the time of lodgement.</p>	
Tasmania	<i>Land Titles Act 1980</i>	<p>A caveat must be supported by an agreement charging real property. It is not necessary to charge the specific land.</p> <p>There is no limit on the term of the caveat. A statutory declaration is not required for the lodgement of routine caveats. However, in some cases statutory declarations may be required by the Land Registry to be provided by the caveator to substantiate the basis of the caveat.</p>	
Western Australia	<i>Transfer of Land Act 1893</i>	<p>A caveat may be lodged by the equitable chargee to protect an equitable charge.</p> <p>A statutory declaration is not required for the lodgement of routine caveats. However, in some cases statutory declarations may be required by the Land Registry to be provided by the caveator to substantiate the basis of the caveat.</p>	

Teresa Miraglia heads the securities practice of the Melbourne Property Team. She supervises high volume 'retail' home lending for a government business enterprise in the Indigenous sector. She has acted for Commonwealth agencies in setting up processes and documentation for the securing of Commonwealth debts and also has been involved in establishing highly complex security arrangements for the repayment of multi-million-dollar debts owned to the Commonwealth and recovered through a Commonwealth regulatory agency. These have included multiple mortgages of land with cross collateralisation, company charges, mortgages of business, mortgages of livestock and the like. Teresa has acted for the Commonwealth in establishing securities to secure the performance of non-monetary obligations such as bail conditions in high profile extradition proceedings.

Michael Brann has a strong background in commercial law, contracts, finance and security documentation, real property transactions and negotiating and drafting a range of commercial agreements including sponsorship agreements. He has acted in relation to a broad spectrum of transactions, including the sale and purchase of real estate, subdivisions, leasing and loan and security transactions.

Lee-Sai Choo heads our Perth Commercial team. He has a specialist property and commercial law practice and has assisted Australian Government departments and agencies with probity advice, commercial arbitration, real property acquisitions, secured loans and disposals, leasing, tenders, auctions and major asset disposals. Lee-Sai advised and continues to provide ongoing advice to Indigenous Business Australia on its loan and security documentation for the home ownership and business loan programs and is the national commercial contact for IBA.

Notes

- 1 Whether the debt will be capable of being paid in full or in part by exercising the security will depend largely on the value of the security and the value of any equity in it, coupled with the existence of any other secured creditors.
- 2 The law related to securities over personal property is currently being reformed. The key focus of the reforms is the creation of a single national register for securities over personal property (see AGS *Commercial note* No. 29, 'Personal Property Securities Bill 2008: an overview of the new regime' (2 September 2008); and the new Personal Property Securities Bill 2009).
- 3 This charge is different from a company charge in that a company charge is registered under the Corporations Act with the Australian Securities and Investments Commission.
- 4 For example, see s 56(2) of the *Real Property Act 1900* (NSW). In contrast, it is possible in Queensland to register a charge against the property to secure a debt. This would take the form of a Form 14 General Request. However, for a charge to be registered against the title, there must exist an instrument in writing whereby the debtor agrees to the property being charged to secure the debt. In practical terms, there is no advantage in proceeding by way of registered charge as compared to a registered mortgage. Indeed, it is preferable that the mortgage procedure be adopted, as it would provide additional protection to a creditor in the event of default by the debtor under the repayment provisions.
- 5 For example, in rare situations, the mortgagee may exercise its right to foreclose, which means that the mortgagee becomes the legal owner of the property.
- 6 There are limited exceptions to this general rule in each jurisdiction. For example, fraud (see s 42(1) of the *Real Property Act 1900* (NSW)).

- 7 There are some exceptions, for example, in NSW, any unpaid land tax is protected by a statutory first charge over the property (s 47 of the *Land Tax Management Act 1956*).
- 8 See footnote 4.
- 9 A caveat will not prevent registration of every type of dealing, including other caveats. The caveat itself can specify that certain dealings are permitted to be registered after the caveat.
- 10 In some jurisdictions, the caveat may expressly allow a subsequent interest to be registered on the title provided the subsequent interest is made subject to the prior interest protected by the caveat.
- 11 Whether this is feasible will however depend on the amount of equity in the land.
- 12 A priority agreement is an agreement between mortgagees and charges which effectively alters the priority principles that would otherwise apply.

AGS contacts

AGS has a team of securities experts who can assist with securities over the full range of real and other property interests. For further information please contact one of the following specialists for assistance with any property issues.

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ISSN 1433-9549
Approved Postage PP 255003/05310