Taking charge: back to basics for lenders enforcing security over real estate

Against the challenging economic backdrop, many businesses may find themselves struggling to keep up with debt repayments. In a distressed market, it is important that lenders understand their enforcement options should they end up in the last chance saloon with defaulting borrowers. In this short note, we discuss the most common types of security taken over real estate (focussing on registered land) and how this can be enforced.

1. Mortgages over land – back to basics

> **Legal mortgages** – a legal mortgage typically involves the transfer of title to an asset by way of security for particular obligations on condition that the asset will be transferred back once the secured obligations are discharged. In the case of land in England and Wales, legal title is not actually transferred although the lender is given practically equivalent rights to those of a legal owner. A legal mortgage is also known as a charge by way of legal mortgage, and this is the way in which security over real estate is typically taken in England and Wales – it is the most robust form of security over real estate.

> **Equitable mortgages** – conversely, an equitable mortgage transfers only the beneficial interest in an asset to the lender. This type of mortgage would typically be used where the borrower only has a beneficial (or equitable) interest in the property itself (for example, it owns the beneficial interest under a trust, or it has an equitable interest under a sale contract or agreement for lease). However, an equitable mortgage will also arise (inadvertently) where the necessary formalities for creating a legal mortgage have not been satisfied.

2. Floating charges – the "catch all" form of security

> **What is it?** – 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 by way of security for particular obligations on the part of the borrower. A floating charge will often be taken at the same time as a fixed charge or legal mortgage, but is also intended to capture assets in addition to those that are caught by the specific fixed charge or legal mortgage.

The effect of this is that there may well be properties owned by a borrower which are not mortgaged, but may still fall within the wider security package under a floating charge.

> **Crystallisation** – a floating charge can crystallise into a fixed charge if certain events occur (for example when the borrower fails to repay or enters into some form of insolvency process), at which point the borrower's ability to deal with the charged assets will be restricted.

3. Security Formalities

It is important to remember, and comply with, the following basic principles (which go to the heart of the validity of the relevant security):

> **Execution as a deed** – a legal mortgage must be executed as a deed and expressed to be by way of legal mortgage.

> **Registration at Land Registry** – security which is taken in respect of registered land should be perfected by registration at the Land Registry – legal mortgages will need to be registered against the title to the property to enable the security to take effect as a legal mortgage. Until registration, the security takes effect only as an equitable mortgage – but certain enforcement options (including the power of sale) are still available during this period.

Note that importantly a legal mortgage will not be void/unenforceable for failure to register at the Land Registry (but such failure could prejudice the priority position of the security). This is because legal mortgages rank in priority in the order shown in the charges register on the Land Registry title to the property and not the date they were created.

A floating charge can be registered as a notice on the charges register of the relevant title at the Land Registry, but in most instances floating charges will not be protected this way.

> **Registration at Companies House** – where the chargor is a UK company or LLP, registration at Companies House is also required (and this should take place before registration at the Land Registry, since the Land Registry requires a copy of the Companies House certificate of registration). Registration of the charge at Companies House must take place within 21 days of the creation of the security interest. The recent High Court decision of *Bushby and another (as joint administrators of Rodus Developments Ltd) v Actua Investment LLC* [2022] highlights the importance of complying with the relevant registration requirements – in that case, the Court declared an equitable charge void for non-registration at Companies House and cancelled an associated pending application for registration of the equitable charge at the Land Registry.

4. Enforcement options

Four principal enforcement remedies are recognised by law and are usually expressly conferred in the documents creating the security.

These remedies are as follows:

> a power to sell the secured assets (known as the mortgagee's power of sale);

> a power to appoint a receiver of the secured assets;

> a power to take possession of the secured assets – this can be done by taking physical possession of the mortgaged property (which is rare) or by obtaining an order for possession; and

> a power to foreclose – the process whereby the secured party takes outright title to the secured property in discharge of the debt. This is very rarely used in practice for security over commercial property.

Enforcement is usually the very last resort, after lenders have exhausted all other options. Lenders are, however, well advised to understand their options up front as it is usually wise to act quickly to maximise the value from the asset as soon as possible. In addition, lenders should always seek bespoke advice on their specific remedies, as these will differ depending on the type of security in question.

This is a complex area; if you would like to discuss any of the issues in this note in more detail, please do not hesitate to contact your usual Linklaters contact.

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