



## Land registration – more changes on the horizon for secured lenders?

On 24 July 2018 the Law Commission made 53 recommendations for reform of the Land Registration Act 2002 ("**LRA 2002**") in a long-awaited report which runs to 587 pages<sup>1</sup>.

This article highlights the recommendations likely to be of most interest to real estate financiers.

### Tacking further advances

Tacking is a useful device which enables a lender to add (or "tack") a further advance to an original secured loan, such that the further advance enjoys the same priority as the original loan. Absent the ability to "tack" the further advance to a lender's existing security, a subsequent charge would have priority over it.

Under section 49 of the LRA 2002 a further advance made by the proprietor of a registered charge can take priority over a subsequent charge if one of the conditions specified in section 49 is satisfied. However, the fact that the LRA 2002 only permits tacking by "*the proprietor of a registered charge*" has long caused concern in the syndicated loans market as the lenders who advance the monies will not be the proprietor of the registered charge. Instead, in a syndicated loan structure the proprietor of the registered charge will be a security trustee who holds the benefit of the security on trust for the syndicate of lenders from time to time.

Recognising this concern the Law Commission has delivered some good

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<sup>1</sup> Updating the Land Registration Act 2002.

news for the syndicated lending market. Its report recommends extension of the existing tacking provisions to enable the tacking of further advances by beneficiaries of an express trust of a registered charge.

However, so far as tacking is concerned, it is not all good news. Although consultees had favoured clarification of the meaning of "further advances" the Law Commission stopped short of making any recommendations for change because it considered that any definition of further advances has implications beyond mortgages over registered land. However, it did provide its view that if a loan provides for advances to be made in instalments, payment of an instalment would amount to a "further advance" under the LRA 2002 (and therefore be capable of being "tacked" to an existing registered charge for priority purposes).

The Law Commission also decided not to make any recommendations in relation to the following tacking-related issues on the basis they would be better addressed within a wider project relating to mortgages.

- The fact that the LRA 2002 provides that an obligation to make further advances must exist at the time the charge is granted and still exist at the time the further advance is made. Often the obligation to make further advances is conditional on the borrower's compliance with the terms of the charge, which might prohibit the borrower from granting subsequent charges. However, the grant of a subsequent charge could serve to release the first chargee from an obligation to make further advances. This would mean that the first chargee cannot bring itself within the drafting of the relevant statutory provision in order to assert priority over a subsequent charge at the very point it would want to be able to rely on the relevant provision of the LRA 2002.
- The fact that tacking is possible if the parties to the first charge have agreed a maximum amount for which the charge is security, and at the time of creation of the subsequent charge the agreement recording the maximum amount was entered in the register in accordance with the rules. This particular provision of the LRA 2002 (which is exclusive to registered land) has been criticised as contrary to the decision in *Hopkinson v Rolt*. In that case the House of Lords decided (by a majority) that once a chargee has notice of a second charge, any advance made afterwards by the first ranking chargee will rank after the second charge. The underlying rationale was that if a chargee could use his or her existing security to secure security for advances which may never be made, this could effectively preclude a chargor from later raising money elsewhere. One concern raised is that this provision of the LRA 2002 could, theoretically, enable a first chargee to cite a much higher maximum figure than is justified. That in turn would then give that chargee exactly the monopoly over the chargor's finances which the majority of the House of Lords in *Hopkinson v Rolt* had

been concerned about back in the nineteenth century.

### **The HM Land Registry title indemnity and the position of mortgagees**

Under the current land registration regime every property owner's title is backed up by an indemnity from HM Land Registry ("**HMLR**") which protects that property owner against loss if a mistake is made in the title register. This "mistake" may be the registration of a forged transfer, mortgage or discharge of a mortgage. The indemnity means that when a property fraud affects a registered proprietor's title, the registered proprietor can look to the HMLR indemnity to meet its loss. HMLR, having paid the indemnity, is then given rights of recourse to enable it to seek to recover its losses against a party who is at fault. However, historically, the percentage of indemnity payments recovered by HMLR has been low.

The Law Commission in its Consultation Paper explored various options for reform. One option put forward was placing a cap on the indemnity amount. This option was widely opposed by consultees and the Law Commission decided not to pursue it.

Another option explored was to limit the circumstances in which mortgagees can claim an indemnity. The Law Commission looked at two options for reform in respect of mortgagees:

- a) limiting the ability of mortgagees to obtain an indemnity to situations in which a mortgage was granted on the basis of a mistake already contained in the register; and
- b) placing mortgagees under a statutory duty to take reasonable care to verify the identity of the mortgagor, with the indemnity only being available if the mortgagor had complied with the statutory duty.

The good news for mortgagees is that the Law Commission opted not to pursue either of these options. This was largely on policy grounds, as to do so would mean treating mortgagees differently to other indemnity claimants.

Instead the Law Commission has recommended introducing a new "universal" statutory duty of care for conveyancers and other legal professionals who verify identity in respect of identity checks. HMLR will identify and outline the steps to be taken by a conveyancer when verifying a client's identity. A conveyancer who has complied with the prescribed steps will not be liable to HMLR, even if a fraud is successful. However, a conveyancer who has not complied will be liable to HMLR for any indemnity HMLR has been required to pay out.

The report specifically makes it clear that conveyancers to mortgagees will be subject to this duty. Also, where a mortgagee itself makes an application to HMLR, the mortgagee would be required to comply with this new statutory duty of care and take reasonable steps to verify the mortgagor's identity.

## **Restrictions protecting obligations in registered charges**

Restrictions are often registered in a title register to protect obligations in registered charges. They usually have the effect of preventing the registered proprietor of the land from making any disposition of the land without the chargee's consent.

For example, the current form of the LMA's Real Estate Finance security agreement for investment transactions provides that the chargor consents to a "Standard Form P" restriction being registered against the title of the mortgaged property. This Standard Form P restriction provides that no disposition of the registered estate can be registered without the proprietor for the time being of the charge referred to in the charges register (or their conveyancer) providing signed consent in writing.

In its original consultation document the Law Commission identified some policy concerns arising from the practice of registering restrictions to protect an obligation in a registered charge. In particular, it considered that this type of restriction can prevent a registered proprietor from obtaining finance from other sources, or prevent any further mortgage that the proprietor does grant from being registered. It can also delay a sale of the land.

Consultees offered differing views on the use of restrictions to protect the terms of mortgages.

The good news for secured lenders is that the Law Commission stopped short of recommending any change to the current practice of using restrictions to protect obligations in registered charges in the report. The bad news is that the issue has not gone away for ever. The Law Commission has recommended inserting a power into the LRA 2002 to allow rules to be made which could limit the types of contractual obligation that can be protected by restriction, or which limit the form of restriction available based on the type of contractual obligation. In each case, rules can only be made after public consultation, so watch this space...

## **Other issues of potential relevance to secured lenders**

The report also makes various other recommendations for change which could be relevant to real estate financiers, but which are less likely to impact on day-to-day transactions. These include the recommendations described below.

- A new scheme to govern rectification of the register. Of particular interest to mortgagees, the Law Commission has recommended that a chargee who has been registered by mistake (as a result of a fraud, for example), or the chargee of a registered proprietor who has been registered by mistake, should not be able to oppose rectification of the register (once a mistake has been found by the registrar or a court) so as to correct that mistake by removing its charge. The basis for this recommendation stems from the fact that the mortgagee should be indifferent as to whether the charge remains in the register given that the mortgagee should be

indemnified by HMLR if the charge is removed.

- A recommendation that it should be possible for beneficiaries of an agreed notice to be identified in the notice, and for the notice to be updated where the identity of the beneficiaries changes.
- A recommendation that insolvency practitioners and attorneys acting under a power of attorney should be able to apply to cancel a unilateral notice when they are acting or appointed on behalf of a registered proprietor.
- Recommendations in relation to sub-charges – in particular to ensure that purchasers buying property from mortgagees are protected from limitations on a mortgagee's power to deal with the property which are not reflected in the register.



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