

Article Information

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Taking Security: Mortgages and Security Interests

When funds are loaned to a borrower on a secured basis the lender will usually secure the debt by way of a mortgage over residential or commercial property (real property) or as a security interest over the borrower's personal assets, business or company (personal property). Depending on the nature of the loan, a lender may take security over both real property and personal property of the borrower.

This article will provide a brief summary on the operation of mortgages and security interests, as well as key differences to be considered.

Mortgages

A Mortgage is granted over real property and is the most common form of security for a secured loan as it is easier for a lender to secure its debt against a simple and stable asset (in terms of value).

What is a mortgage?

Prior to 1863, under Old System title, a mortgage required a borrower to forfeit legal ownership of their land (real property) to a lender until the loan had been repaid in full (ie. the borrower / mortgagor would transfer the legal title to the lender during the term of the loan). During the loan term, the borrower only held an equitable interest in the land known as equitable redemption. Once the borrower had repaid the loan, the lender would execute a transfer of the land back to the borrower, or in some cases, court orders were sought for the lender to do so.^[1] Whilst Old System title was satisfactory, different title deeds could be drawn up for the same piece of land, causing uncertainty as to land ownership. Often, careful examination of a chain of deeds, with a minimum period of 30 years, was required to determine the true owner of the land (otherwise known as evidence of the good root of title to the land).

The transition to a Torrens title system 'simplified ownership precisely', as it ensured all interests in the land were recorded on one title deed for a property, eliminating the need to tediously search the register to evidence a good root of title to the land.^[2] The operation of mortgages under Torrens title system no longer requires the legal title to the land to be transferred from the borrower to the lender (in the true sense of a "mortgage"). Instead, a Torrens mortgage is simply created as a statutory charge over the land.^[3] In *Guthrie V Australia & New Zealand Banking Group* (1991)^[4], Justice Meagher explained:

"When land is under Torrens title, in view of the Real Property Act 1900, s 57, which provides that a mortgage under that Act has the effect of a security but does not operate as a transfer of the legal estate in the mortgaged property, a statutory mortgage has the same effect as a charge would have had if the land were held under common law title"^[5]

In doing so, the borrower remains as the legal proprietor of the land but will be prohibited from, among other things, disposing of the land, leasing, sub-dividing or changing the use of the land without first obtaining the lender's consent. Once the loan is repaid, the lender merely discharges the mortgage from the land (which is really a charge over the land). However in the alternative, if a borrower defaults the lender has the right to sell the land and recover the debt from the proceeds of that sale.

Prescribed form for Mortgages

The *Real Property Act 1900 (NSW)* (**RPA**)^[6] prescribes a standard mortgage form to be used (the National Mortgage Form). The mortgage form and requirements differ slightly from state to state. In NSW, it is a requirement that both the borrower and the lender sign the mortgage form. In addition, reasonable steps must be taken to verify the identity of the mortgagor. It is interesting to note that the National Mortgage Form is a deed, that does not require consideration to be established between the parties and is immediately binding on a party from the moment they sign.

Security Interests

Whilst a Torrens mortgage under the RPA applies to real property only, a borrower's personal property can also be secured by a lender by way of a security agreement that creates 'Security Interest(s)' under the *Personal Property Security Act 2009*^[7] (Cth) (**PPSA**). A security interest is defined as:

"an interest in personal property provided for by a transaction that, in substance, secures payment or performance of an obligation (without regard to the form of the transaction or the identity of the person has title to the property)".^[8]

It is important to note that a security interest under the PPSA only recognises security interests in personal property and excludes interests in real property:

"personal property" means property (including a licence) other than:

- (a) land; or
- (b) a right, entitlement or authority that is:
 - i. granted by or under a law of the Commonwealth, a State or a Territory; and
 - ii. declared by that law not to be personal property for the purposes of this Act."^[9]

Typically, a security interest will arise when a lender and a borrower enter into a security agreement giving rise to a lender's (secured party) interest in the personal property of the borrower (grantor). A general security interest over all personal property of a grantor includes current and future assets that are both tangible (such as vehicles and equipment) and intangible (such as a patent). In the event of default, the lender may enforce a security interest under the PPSA by selling the personal asset and recovering the amount owed. It is interesting to note that the majority of general security agreements over all of the property of a grantor that give rise to a security interest, are also drafted to contain charging clauses over any present and future real property of the grantor, despite the PPSA not recognising security interests in real property (refer to our article on [Myth Busted – Understanding the Removal and Release of PPS Interests](#)). The reason for the charging clause over any present and future real property is largely to address any administration risk that a secured party / lender may be exposed to in the provision of the loan to a borrower.

No prescribed form for security interests

Also differing from a Torrens mortgage, the PPSA does not prescribe a form or document to be used when creating or registering a security interest on the PPS register. A security interest may be created irrespective of what document has been used, as long as (in respect of a non-PMSI registration) a registration on the PPSR is made within 20 business days after the **signing** of the security agreement.

Key Takeaways

In essence, mortgages and security agreements (giving rise to security interests) are similar in that they secure a debt owed by a borrower to a lender. Further, both mortgages and security agreements contain charging clauses, however they generally apply to different types of assets:

- a Torrens mortgage is granted by the mortgagor in favour of the mortgagee and constitutes a charge over certain real property and must be registered using the National Mortgage Form in the format prescribed by the titles registry for the applicable State; and
- a security agreement is granted by the grantor in favour of the secured party over all of the grantor's present and after-acquired property and gives rise to the creation of security interest(s) and in the majority of security agreements, includes a charge over all of the grantor's real property. There is no prescribed form provided by the PPSR for the security agreement to adopt.

For more information relating to mortgages or security interests please contact Banking and Finance partner, Greg Conomos.

- [1] Bryson, John P QC, *The History of Property Law* (2017).
- [2] Stein, R, *The Principles, Aims and Hopes of the Title by Registration* (1983) 9(2) *Adelaide Law Review* 267.
- [3] *Real Property Act 1900* (NSW) No 25 Part 1A s 3.
- [4] *Guthrie v Australia & New Zealand Banking Group Ltd* (1991) 23 NSWLR 672.
- [5] *Ibid* at [8].
- [6] *Real Property Act 1900* (NSW).
- [7] *Personal Property Security Act 2009* (Cth).
- [8] *Personal Property Security Act 2009* (Cth) s 12.
- [9] *Personal Property Security Act 2009* (Cth) s 10.