Taking Security on Commercial Properties

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TAKING SECURITY ON COMMERCIAL PROPERTIES

Introduction

The purpose of a bank or other lending institution taking security over commercial property is to ensure a quicker and more assured payout in the event that a borrower company goes into receivership, examinership or liquidation.

In this regard, there are different types of security which the lending institution may put in place in order to safeguard its investment.

Before detailing the various methods of taking security, the difference between a fixed charge and a floating charge should be explained. A fixed charge is security over a particular asset. Conversely, a floating charge constitutes a charge over all assets of the borrower company as acquired from time to time. The company remains free to deal with its assets in the ordinary course of business. The charge only becomes a fixed charge upon crystallisation. Crystallisation occurs on the appointment of a receiver or liquidator and the floating charge fixes on all assets in the ownership of the company at that time.

A fixed charge gives the best position to a lending institution as regards any consequences of enforcement[1]. The main disadvantage with a floating charge is that preferential creditors such as the revenue commissioners rank in priority to the floating charge, but after the fixed charge.

Unless the lending institution lodges a notice of the fixed or floating charge created by a company within 21 days of its creation with the Companies Office, the charge will be void against the liquidator or any creditor of the company. Accordingly, it is essential to ensure that a Companies Registration Office ("CRO") Form C1 is completed by the borrowing company on the occasion of completing the loan transaction and the Form C1 is filed with the CRO as quickly as possible after the completion of the transaction and, in any event, within 21 days.

[1] The priority on insolvency as set by Section 285 and 98 of the Companies Act, 1963, as amended.

Debenture

A debenture is a document which contains a covenant by a company to pay all sums due or to become due by the company to the lending institution and which contains a charge (fixed and/or floating in favour of the lending institution).

Mortgage

A legal mortgage is commonly understood to be a 'conditional transfer' of a property to a lending institution that may become absolute if the mortgagor falls into arrears and is unable to make the repayments which it covenants to make.

An equitable mortgage passes only an equitable estate or interest, either because the form of transfer or conveyance used is an equitable one (i.e. operates only as between the parties to it and those who have notice of it, such as an equitable mortgage by deposit of title deeds), or because the mortgagor's estate or interest is equitable (i.e. it consists merely of the right to obtain a conveyance of the legal estate).

The main disadvantage with an equitable mortgage is that it is not as secure as a legal mortgage, primarily because it is not usually registered in the Land Registry or Registry of Deeds. Accordingly, legal mortgages, which have been registered, will gain priority over equitable mortgages.

Charge

A charge is the form of security for the repayment of a debt or performance of an obligation consisting of the right of the lending institution to receive payment out of some specific fund or out of the proceeds of the realisation of specific property.

There is a difference between 'mortgaging' a property, title to which has been registered in the Land Registry, and 'mortgaging' an unregistered property. In fact, a Registry of Deeds property is mortgaged and a Land Registry property is charged.

The distinction is that unregistered property (i.e. property with a Registry of Deeds title) is conveyed, leased or assigned by the borrower to the lending institution (subject to the borrower's equity of redemption in the property). The equity of redemption describes the rights retained by the borrower in relation to the property and includes the borrower's equitable right to get the title back and have it vested in him once more when the loan is repaid.

Registered land (i.e. property with a Land Registry title) may be 'mortgaged' only by the registered owner by means of a registered charge. Unlike a mortgage, a charge involves no transfer of ownership to the lending institution. Ownership remains with the registered owner and the lending institution only acquires rights over the property.

Pledge

A pledge arises where documents of title for a property are delivered by the pledgor to the pledgee to be held as security for the payment of a debt or for the discharge of some other obligation. The subject matter of the pledge will be restored to the pledgor as soon as the debt is discharged. Where a definite time for payment has been fixed, the pledgee has an implied power of sale upon default.

The difference between a pledge and a mortgage is that a pledgor of property only has a 'special title' to the property, while a mortgagee has an absolute title to the property subject to the right of redemption. A further distinction between a pledge and a mortgage is that a pledgee (unlike a mortgagee) cannot obtain foreclosure but has a right to sell the property.

Priority of Security

As stated above, the fundamental reason for a credit institution taking security is to safeguard its investment and to ensure a faster payout should the borrower company go into receivership or liquidation. Accordingly, priority of security is an essential consideration in circumstances where more than one lending institution advances secured facilities to a borrower. Priority of security refers to the order in which the lending institution shall rank for payment on a distribution of the borrower's property, which is subject to the lending institution's security.

Endnotes

The Priority on insolvency as set by Section 285 and 98 of the Companies Act 1963, as amended, is as follows:

- creditors secured by a fixed charge;
- preferential creditors (e.g. certain taxes, rates, redundancy payments);
- creditors secured by a floating charge; and
- ordinary creditors.

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