

Chapter 25

Question 1: What is the difference between a 'mortgage' and a 'charge'? Why is the legal charge by way of mortgage described as a hybrid security?

The generic term mortgage is often used to refer to security interests in land but it is important to distinguish between a mortgage and a charge. We explore the distinction in Sections 3.3 and 3.4.

A mortgage confers a proprietary interest by way of security upon the lender by transferring the borrower's interest in the mortgaged property to the lender subject to the lender's agreement to retransfer that interest to the borrower upon repayment of the loan. This process of retransfer is known as redemption and the borrower's right to insist upon redemption is known as the borrower's right to redeem. The borrower's right of redeem may be exercised in equity even though the legal date for repayment of the loan may have passed and will only be lost should the lender exercise his right to foreclose – see Section 1 of Chapter 27. The borrower's interest in the property is known as an equity of redemption. The lender thus becomes the holder of the borrower's title to the mortgaged property subject to the borrower's equity of redemption. The mortgage as a form of security is based upon a fiction (of which the parties are usually ignorant) that the lender is the legal owner of the mortgaged property with only the borrower's equity of redemption distinguishing a mortgage from an outright sale.

A charge gives rise to a new proprietary interest in favour of the lender over the borrower's property. In contrast to a mortgage there is no transfer of the borrower's existing interest but the creation of a new burden upon the borrower's ownership. This interest by way of charge appropriates the borrower's property to the repayment of the loan. In other words it entitles the lender to look to the borrower's property should the borrower fail to repay the loan, for instance by insisting that the property be sold. When the loan is repaid the charge will cease as there is no longer any appropriation.

A legal charge by way of mortgage of land is described as a hybrid security because, although in legal form it is created by way of charge, section 87(1) of the Law of Property Act 1925 provides that a legal chargee is to enjoy the same protections, powers and remedies as if a legal mortgage had been created by vesting a lease for 3,000 years in the lender. Thus unfortunately the mortgage fiction continues to be perpetrated. We explore the nature of the legal charge by way of mortgage further in section 4.2. The reason for the rather illogical form of this pre-eminent security over land lies in history, which we relate in section 4.1.

Question 2: In what circumstances may an equitable form of security interest be created?

We examine the equitable forms of security over land in section 4.3. First, there is the equitable charge of the legal estate where the borrower has agreed to create a legal charge or the parties have not employed the correct formalities. A deed which the parties must register is required if the parties are to create a registered legal charge whilst a valid agreement to create a legal charge must comply with s 2(1) of the Law of Property (Miscellaneous Provisions) Act 1989.

Secondly, there is the equitable mortgage of the borrower's equitable estate, for instance the borrower's interest under a sale and purchase agreement of land or under a trust of land.

Lastly there is the equitable charge where the parties demonstrate an intention that the borrower's estate in the land is to be appropriated to secure the repayment of a debt.

McFarlane explains that it is important to distinguish between the first and last of these different forms of equitable security since they may be acquired by different means and give rise to a different relationship. He suggests the use of the terms 'equitable charge' for the first type of equitable security and 'purely equitable charge' for the last type.

Question 3: What advantages would there be if the Law Commission's recommended changes to the form of land mortgages were enacted?

We have extracted parts of the Law Commission's Report No 204, which was published as long ago as 1991, in sections 4.2 and 4.3 when we considered the legal charge by way of mortgage and the equitable forms of security over land.

The Law Commission's Report criticised the confusion that exists between the forms of mortgage and charge in the legal charge by way of mortgage and recommend its replacement by a statutory form of security which would clearly define the relationship between the borrower and lender. By so doing, the confusion resulting from the distinction between the mortgage and charge and inappropriateness of the hybrid legal charge by way of mortgage, perpetrating as it does the fiction that lies at the heart of the mortgage form, would be removed.

In relation to equitable security interests in land, the Law Commission noted the unnecessary complexity of the three forms of equitable security and advocated the rationalisation of these forms by recognising that the new statutory form of mortgage may be created either formally or informally.

Students are referred to the Law Commission Report No 204 for more detail of the Law Commission's proposals.

Question 4: Do you agree that the concept of an equity of redemption has outlived its usefulness?

We examined the concept of the borrower's equity of redemption in section 5. Under the traditional mortgage by way of conveyance or sub-demise the borrower's equity of redemption was of fundamental importance – see question 1 above. Indeed its development was a key achievement of the chancery courts – see the interesting article by Sugarman and Warrington in the suggested further reading.

However, all mortgages of land must now be created by way of legal charge – see section 23 of the Land Registration Act 2002. Both Nield and Watt argue that the concept of the borrower's equity of redemption under a legal charge by way of mortgage is unnecessary and should be abandoned as perpetrating the fiction of the legal mortgage by conveyance which sees the lender as the owner of the land and the borrower as the holder of a mere equity of redemption – see section 5.2. The courts are even sometimes beguiled by this fiction; see for example *Abbey National Building Society v Cann*, considered in Sawyer in *A World Safe for Mortgagees – Registering a Scintilla of Doubt in Cooke* (edn. Modern Studies in Property Law Vol 1) Hart 2001, 201, *Horsham Properties Group Ltd v Clarke*, *Scott v South Pacific Mortgages Ltd*...

It remains important nevertheless to continue to recognise the borrower's equitable right to redeem, entitling them to repay and discharge the lender's security even though the contractual date for repayment agreed by the parties may have passed.