



Competing Priorities

The Message:

The seller in a sale and leaseback must ensure his new lease has priority over the buyer's mortgage.

The Case:

Re North East Property Buyers Litigation [19 November 2010] is a significant test case on competing priorities between occupiers, who sold their homes under sale and leaseback schemes, and mortgagees for the buyers of the properties.

A number of property owners entered into equity release schemes. The owners were of modest means and the schemes proposed a quick purchase and leaseback of their properties enabling them to retain occupation in the long term, while releasing some equity.

The property owners sold their properties to nominees of North East Property Buyers ("NEPB"). In most cases, the price paid under the contract was the market value, but the owners paid back to NEPB a significant part of the completion money. The owners alleged that promises were made to them by NEPB as to their right to occupy the properties, their contention being that they were offered a tenancy.

The nominee purchasers of the properties applied for loans from mortgagees. On the same day, sale contracts were exchanged between the owners and the nominees and the transfers of the properties to the nominees and the mortgages in favour of the mortgagees completed. Following completion, NEPB granted assured shorthold tenancies to the now former property owners.

Subsequently, the mortgagees sought possession of the properties, there being substantial arrears under the mortgages and the nominees had no defence to the claims. The key issue was whether the mortgagees' rights took priority over any rights of the former owners who occupied the properties.

There were about 100 cases in all where mortgagees had begun possession proceedings against former property owners who had sold their homes to NEPB under sale and leaseback schemes. The former owners could potentially lose their rights to occupy their homes. The outcome of this case was, therefore, critical.

The former owners argued that they had priority over the mortgagees since their interests were "overriding interests" existing before the mortgages were completed. Such interests, it was argued, arose at the time of the contract to sell and leaseback, which was exchanged before completion of the mortgage and were also based on their physical occupation of the properties. Looking at the reality of the situation, this was a sale and leaseback to the former owners where the leaseback was created as a result of NEPB's promises and NEPB's nominees never had more than a title to the properties subject to the former owners' equitable rights and that was all that was charged to the mortgagees.

The mortgagees, in response, did not accept that there was a necessary time interval between contract and completion, which were all part and parcel of the same transaction.

The High Court decided in favour of the mortgagees. A person claiming an equitable interest, such as the former owners, cannot normally get priority. There is no "moment" in time between contract and completion to enable such an interest to arise. Prior to completion, the owners' equitable rights arising from the contract were at best personal and not proprietary and, therefore, could not give rise to overriding interests, and NEPB could not grant a proprietary right to possession since the owners were in possession. The mortgagees, therefore, had priority over and were not bound by any rights of the former owners. The Court was, however, minded to grant permission to appeal since its decision conflicted with a previous court decision.

In a sale and leaseback situation, sellers should ensure that priority for their leaseback is protected in relation to any mortgagee of the buyer, or that the buyer obtains the mortgagee's consent to the lease.