

Number 17

## Mortgagees of Leasehold Property Left out in the Cold

A recent decision of the Court of Appeal<sup>1</sup> and changes to the rules of court procedure have left lenders which have security over leasehold property at risk of their security being extinguished without notice if a landlord forfeits the lease.

In *Smith v Spaul* the claimant landlord sought to forfeit a lease on the grounds of breaches of repairing covenants. The landlord served a section 146 notice on the mortgagee which had taken possession of the premises and which then served a counternotice claiming the benefit of the Leasehold Property (Repairs) Act 1938 requiring the landlord to obtain the court's permission before forfeiting the lease. However, the landlord commenced forfeiture proceedings without seeking the court's permission and the Court of Appeal held that a mortgagee is not entitled to be served with a section 146 notice and that a landlord would not be bound by a mortgagee's notice under the 1938 Act.

### The Effect of the Court of Appeal's Decision:

- Mortgagees of commercial leases have no automatic entitlement to be notified of proceedings commenced by a landlord to forfeit a lease. There is no general duty on a landlord to notify a mortgagee that it intends to take such action.
- Even a mortgagee which has taken possession of premises may know nothing of the forfeiture of a lease until it is too late to do anything about it.
- To restore a lease and obtain relief from forfeiture, a mortgagee would probably have to remedy the breaches and pay the landlord's costs.

### The Reason for the Decision

The Court of Appeal has taken the view that because a landlord and tenant are contractually bound by virtue of the lease, their fundamental relationship is unaffected by a mortgage, even if a mortgagee has already taken possession of the premises.

### The Change to the Court Rules

It is no longer the case that a landlord of commercial premises must name in possession proceedings all parties which may be entitled to relief from forfeiture, although it does remain the case in residential possession proceedings.

If a landlord decides to forfeit a commercial lease for non-payment of rent by taking peaceful possession of the premises, the forfeiture can be without notice even to the tenant and does not require a possession order to be obtained.

<sup>1</sup> *Smith v Spaul* [2003] 1 All ER 509

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In cases of non-rent breaches a landlord must serve a notice pursuant to section 146 of the Law of Property Act 1925. There is no general duty on a landlord to serve it on a mortgagee so by the time a mortgagee becomes aware of the problem it may be too late to take any action.

In order to preserve its security, a mortgagee would have to apply for relief from forfeiture, but, of course, to be in a position to do so, the mortgagee would have to be aware of the forfeiture in the first place. There is normally a period of six months in which relief from forfeiture may be obtained. A mortgagee would be entitled to apply for relief from forfeiture but would probably be required to remedy the breaches and pay the landlord's costs as a condition of obtaining relief. In circumstances where a landlord has regained possession a court will only set aside judgment in exceptional circumstances.

## What Can Mortgagees Do to Protect their Interest?

- Require a provision to be included in the lease that the landlord will not forfeit the lease without notifying the mortgagee.
- Obtain an undertaking from the landlord that he will not forfeit the lease without notifying the mortgagee. However, the undertaking may not bind the landlord's successors in title.
- Monitor the mortgagor's business and management of the premises through regular site inspections to spot potential trading problems or breaches at an early stage. The cost of this may be recoverable under the charge.
- Give notice to a landlord of a charge. A landlord may alert a mortgagee to a tenant's breach in the hope that the mortgagee may remedy it at no cost to the landlord.

As a result of these changes, from now on mortgagees of commercial leases should take their own protective measures to ensure they are alerted to potential problems at an early stage, including obtaining legal advice as to how to oblige a landlord to notify them of intended or actual forfeiture.

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June 2003

Readers are advised to take specific advice before acting in reliance on the matters set out in this briefing.

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