

Case Note

Perpetual Trustee Company Limited v Smith [2010] FCAFC 91

by



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The Full Federal Court of Australia has determined that the interests of ‘reverse mortgagors’ as lessees of their former residential properties can constitute an exception to a registered mortgagee’s otherwise indefeasible title under the Victorian *Transfer of Land Act 1958*. Furthermore, in the battle of priorities that followed, the majority of the Full Court considered that the mortgagor who was, through an independent third party arranger, the ultimate financier of the ‘reverse mortgage’ could be imputed with notice of the lessees’ interest, notwithstanding the lack of any direct evidence of such.

A reverse mortgage is a loan often made available to senior citizens who own their own home, whereby they “unlock” the equity to fund their retirement years. The loaned amount is paid in either a lump sum or in instalments throughout the borrower’s remaining years, and is secured against the home in the usual way. The obligation to repay is, however, deferred until the borrower dies or ceases possession (e.g. by moving into aged care). A variation to the classic model is where the borrower/home-owner actually sells the home to the lender or arranger during his or her lifetime, and the lender or arranger grants the borrower tenancy of the home for rest of their life, or until they cease possession for an agreed amount of time (e.g. to move into an aged care). The *Perpetual v Smith* decision dealt with the second variety of reverse mortgage.

Background

The case concerned a scheme operated by a company, called Money for Living (Australia) Pty Ltd, whereby elderly retirees would sell their homes to the associated company Money for Living Property Holdings Pty Ltd (*MFLPH*) in return for a lump sum, an annuity for a fixed period and a life tenancy over the property. A number of the loans were funded by Perpetual Trustee Company Pty Ltd (*Perpetual*), to whom MFLPH would grant a first registered mortgage over the property.

MFLPH ceased trading in late 2005, but not before setting up a number of these reverse mortgage arrangements. The retirees commenced representative proceedings in the Federal Court to protect their leasehold interest in the properties sold to MFLPH (over which Perpetual held mortgages).

In essence, the retirees claimed that the registered mortgages held by Perpetual were subject to their interests as lessees. Perpetual’s position was that it was an innocent third party mortgagee, and upon registration of its mortgages had obtained indefeasible title. In 2008/2009, Middleton J gave a series of judgments generally in favour of the retirees. The two most significant issues on appeal were:

- whether the retirees had interests as tenants in possession under the *Transfer of Land Act 1958 (TLA)* at the time that Perpetual acquired its interests as mortgagee; and, if so
- whether the interests of Perpetual were subject to the interests of the tenants in possession.¹

The *Transfer of Land Act 1958*

As all of the properties were located in Victoria, the TLA applied. Section 42 is the key indefeasibility provision, it relevantly provides that:

“Notwithstanding the existence in any other person of any estate or interest (whether derived by grant from Her Majesty or otherwise) which but for this Act might be held to be paramount or to have priority, the registered proprietor of land shall, except in case of fraud, hold such land subject to such encumbrances as are recorded on the relevant folio of the Register but absolutely free from all other encumbrances whatsoever”

Sub-section (2)(e) contains an exception to this indefeasibility in respect of leases as follows:

“Notwithstanding anything in the foregoing the land which is included in any folio of the Register or registered instrument shall be subject to—

(e) the interest (but excluding any option to purchase) of a tenant in possession of the land;”

Retirees tenants in possession when Perpetual acquired its interest?

Justices Moore and Stone (with whom Dorsett J agreed upon the operation of s42(2)(e) of the TLA) dealt with the question of the time of creation of the tenancies, versus the creation of the mortgages, by analysing the timeline of one transaction that was apparently typical of all other transactions.

The contract for sale and the agreement for the continued (lifelong) tenancy, both between the retiree and MFLPH, had both been executed on 18 November 2004. This was considered to establish:

“... that it was the intention of the parties that MFLPH’s right as owner of the land was to be subject to the right of [the retirees] to remain in possession as tenants for the duration of their lives or until they vacated the property for a period exceeding six months”.

Settlement of the transaction took place on 9 December 2004, when the deposit of the purchase price was paid by MFLPH to the retirees, and the completed transfer of land was exchanged. This was also the date that MFLPH’s mortgage of the property to Perpetual was completed, and was determined to be the commencement date of the tenancy. Registration of the transfer of land to MFLPH and the mortgage to Perpetual did not take place until 4 January 2005 (i.e. both on the same day).

Perpetual submitted that the lease made on 18 November 2004 (by the tenancy agreement) was ineffective, since MFLPH had no right to grant it – the retirees still being the registered proprietors. However, Moore & Stone JJ considered that the retirees had, from the date of execution, a lease in equity arising as a result of their entitlement to enforce their tenancy agreement, as well as an implied tenancy at common law. Further, upon settlement (prior to registration), MFLPH acquired an equitable interest in the fee simple estate, and was able to carve out of that an equitable estate for the retirees. Accordingly, MFLPH not being registered proprietor at the time of the lease was irrelevant.

¹ The existence and consequence of equitable vendor’s liens over the properties was also considered in the appeal (and cross-appeal).

Furthermore, notwithstanding any agreements between Perpetual and MFLPH, there was no entitlement for Perpetual to register its mortgage until the transfer of land had itself been registered – since otherwise the mortgage would have been granted by someone other than the registered proprietor. So even though the transfer of land (to MFLPH) and registration of mortgage (to Perpetual) were lodged for registration at the same time, the transfer preceded the mortgage. That is, MFLPH was, however briefly, the registered proprietor of the land prior to Perpetual’s registration of its mortgage. Since MFLPH had entered into the tenancy agreements prior to this occurring, it followed that, at the time of registration of Perpetual’s mortgage, the retirees enjoyed an interest as tenants in possession of the land for the purposes of s 42(2)(e) of the TLA.

Priority as between the tenants in possession and the mortgagee

Although by operation of s 42(2)(e) the lands were subject to the retirees’ interests as tenants in possession, such statutory protection did not automatically prioritise the tenancy interests over the mortgages. Justices Moore and Stone considered two High Court authorities upon the operation of this section, *Burke v Dawes* (1938) 59 CLR 1 and *Barbra v Gas & Fuel Corporation of Victoria* (1976) 136 CLR 120, and distilled the following relevant propositions:

- the interest of a tenant in possession does not take priority over a subsequent registered proprietor; and
- a registered proprietor in competition with a tenant in possession cannot rely upon the indefeasibility of title that would, were it not for s 42(2)(e), otherwise accrue.

Nothing in the transactional documentation suggested that the retirees intended to subrogate their rights to remain in the homes to the interests of the mortgagee. Accordingly, regardless of whether Perpetual’s interest was legal or equitable, the competition between the interests was to be decided upon general law principles. The question of *notice* of prior interest thus became significant.

As the equitable interest of the retirees preceded any equitable interests of the mortgagees, if the equities were found to be equal, the retirees would seem to take priority. However, by giving MFLPH a registrable transfer, the retirees had armed it with the ability to enter into the mortgages without any mortgagee having notice of their interest. In this regard, it was noted that the retirees could have lodged a caveat giving notice “*to all the world that the registered proprietor’s title [was] subject to [their] equitable interest*”, however, ultimately their Honours declined to find any positive obligation to caveat existed².

The question was, consequently, whether Perpetual had notice of the retirees’ interest. If it did not, then the retirees’ arming of MFLPH would operate to subrogate their otherwise first in time equitable interest to that of Perpetual.

The material before the Court included evidence that those in charge of settlement of the mortgages had no notice of the retirees’ interests. This was, however, considered “*hardly surprising given the comparatively mechanical nature of settlement procedures*”. Their Honours went on to observe that:

“... *no evidence was apparent or was drawn to our attention as to the arrangements pursuant to which the loan moneys were made available. The absence of evidence on this point suggests that there was no evidence that would have assisted Perpetual in this regard. In any event, the very name of the company granting the mortgages, Money for Living Property*

² To find otherwise was considered to amount to conversion of “*a facility that the TLA provides into an obligation*” (at [71]).

Holdings Pty Ltd, would or should have alerted the mortgagee to the need to make enquires. Furthermore, the fact that the mortgaged properties were residential premises occupied by elderly persons ... should have alerted a potential purchaser or mortgagee of the need to make enquiries”

Apparently, the fact of the retirees’ occupation was itself “*constructive notice of their interest which would thus prevail even against a bona fide purchaser of the legal interest*”³. Accordingly, no matter whether Perpetual’s interest was regarded as equitable or legal, the retirees’ interest took priority.

The majority decision⁴ identifies some specific dangers for security takers when financing reverse mortgages, and more generally highlights the minefield of potential higher ranking unregistered interests that awaits those who lose the protection of indefeasibility of title.

³ At [74].

⁴ In a separate judgment, Dowsett J approached the question of potentially battling equities differently. Ultimately, his Honour believed that there was insufficient material before the Court upon the question of priority and considered that the appropriate course would be to have the case remitted to the trial judge for further consideration.