

# The Real Property Amendment (Certificates of Title) Act 2021

## Discussion Paper

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## Foreword

### What?

Since 2013, the system in NSW has been shifting towards a fully electronic model of Land Title. This includes a digital conveyancing and settlements system known as PEXA, which is now being used by lenders, solicitors, and conveyancers.

The *Real Property Amendment (Certificates of Title) Act 2021* [REAL PROPERTY AMENDMENT \(CERTIFICATES OF TITLE\) BILL 2021 \(austlii.edu.au\)](#), by amending the *Real Property Act of 1900*, has effectively abolished paper Certificates of Title (CTs) and Control of Rights to Deal (CoRD).

Under this amendment, the Registrar General will no longer be required to issue CTs or issue CoRD to an Financial Institution on the registration of a first mortgage. CTs will also no longer have to be produced to enable the registration of a dealing, including the registration of a second mortgage.

### Why?

Primarily to safeguard against fraud as well as to eliminate errors and streamline dealings in real property.

The PEXA accreditation process places a significant duty of care on the legal practitioner to electronically certify identities of parties involved in real property transactions. The system is secure: in the period since the electronic system has been operating (2014) there have been no reported cases of fraud.

During the recent coronavirus lock-downs, it was the PEXA system that kept the business of property transactions alive and well, not having to deal with paper conveyancing transactions in person or for the parties to physically attend settlement rooms was a key contributing factor to this success.

### How?

Act of Parliament to amend the Real Property Act 1900 in relation to certificates of title and electronic conveyancing and for related purposes (assented to 24 May 2021).

The new digital system electronically records the transferring, mortgaging and leasing of real property; interests, dealings, and priorities are now transacted and recorded without paper certificates of title and without paper transfers, mortgages, and leases.

### When?

The Real Property Amendment (Certificates of Title) Act 2021 came into effect 11<sup>th</sup> October 2021.

### Where?

New South Wales. However, other states have similar systems in place that produce similar outcomes.

## WHAT THIS MEANS FOR YOU

The highly secure electronic system means:

- Increased security against fraudulent transactions and reduce errors
- Streamlined processes for transferring, mortgaging (including 2<sup>nd</sup> mortgaging), & leasing real property
- Lower transaction costs and faster, more efficient settlement process
- No longer the need for an intending second mortgagee to seek the consent of a first mortgagee:
  - Lower legal costs
  - Faster loan settlements
  - 1<sup>st</sup> mortgagees can no longer withhold consent or object to a second mortgage.



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## Real Property Amendment (Certificates of Title) Act 2021

### Background

The Torrens Title Register remains the single source of information about real property ownership and dealings, it is securely stored and backed up by both NSW Land Registry Services and the Office of the Registrar General.

It gives the land owner an indefeasible title (the owner's interest in the land is not defeated by existing defects in title prior to registration or other unregistered interests); however, there are some limited exceptions to indefeasibility, including prior registered interests, fraud, easements and surveying errors.

In July 2016, the NSW State Government announced its intention to transition fully to a solely electronic conveyancing system (100% e-Conveyancing).

In February 2017, the NSW State Government announced its transition timetable to full electronic conveyancing.

In July 2019, it was decreed that any conveyancing transaction that can be lodged electronically must be lodged electronically.

From 11 October 2021, lodging land dealings in paper are no longer permitted.

With the commencement of the Real Property Amendment (Certificates of Title) Act 2021, s33AAA of the Real Property Act of 1900 is repealed and all current certificates of title no longer have legal effect; the amendments remove the Registrar General's powers to:

- issue certificates of title for real property
- place recordings on certificates of title
- require production of a certificate of title
- require parties with the right to deal with titles to consent when accepting a dealing for lodgement or registration.

### The Principle of Priority

Section 36(9) of the Real Property Act 1900 deals with Priority ([REAL PROPERTY ACT 1900 - SECT 36 Lodgment and registration of documents \(austlii.edu.au\)](#)).

It states, "Deals registered with respect to, or affecting the same estate or interest shall, notwithstanding any notice (whether express, implied or constructive), be entitled in priority the one over the other according to the order of registration thereof and not according to the dates of the dealings".

This means that Priority is determined by the date that a second mortgage, for example, was registered on title and **not** by date of the dealings, ie; not the date which the mortgage was entered into - this is significant in relation to the protection of a second or subsequent mortgagee's interest.

### How It Worked Before the Amendment

Under the Conveyancing Act of 1919, NSW was the only state in the Australian commonwealth that required the production of titles by a first mortgagee in order for an intending second mortgagee to register its subordinated mortgage priority.

The production of title by the first mortgagee being subject to its prior consent; the electronic title was protected by a CoRD held by the first mortgagee.

Depending on which first mortgagee was involved, consent to a subordinated mortgage priority by the first mortgagee may often have been refused: the view in this case is that subordinated mortgagees are simple and less sophisticated in their assessment and pricing of risk, are apt to risky lending practices which increase credit risk exposure beyond a prudential lender's limits thereby heightening the risk of default and diminishing the likelihood of full recovery of capital.



Under the previous regimen, Control of the Right to Deal (CoRD) Consents provided consent for the registration of registry instruments, such as mortgages. However, the CoRD framework was abolished 11 October 2021 with the introduction of the new Act; hence, the request for CoRD holder consent from an intending second mortgagee is no longer relevant or necessary.

Equitable mortgages and liens secured by possession of a CT have now become less secure with the abolition of CTs; alternative security arrangements must be made.

### **The Effect of the Amendment on Property Transaction**

Proprietors of and dealers in real property will now need a lawyer or conveyancer who is a subscriber to an Electronic Lodgement Platform, such as PEXA, to prepare and lodge dealings for registration on the Torrens Register.

Practitioners who are subscribers are required to follow strict obligations, such as verifying their customers' identities, that they have the right to deal with the subject real property, and that they have their customers' legal authorisation to transact on the customers' behalf.

In all instances of property ownership, an Information Notice akin to a receipt will issue which will include the folio identifier, registered dealing(s) and their registration number(s), the subscriber's reference, and the date of registration.

However, a full title search will still be required in order to ascertain the most accurate and up to date title information regarding the subject real property.

### **First Mortgages and Second Mortgages**

First mortgagees may view some second mortgage providers as opportunistic lenders whose recourse in case of default would be the rash possession and liquidation of the security – thereby adding another layer of risk and potentially jeopardising the first mortgagee's position and business (and profit) by bringing its contracted credit arrangements to an early and abrupt conclusion, at times at a loss to all parties.

A second mortgagee's security is the Borrower's (Mortgagor's) residual equity in a mortgaged property; the Borrower (Mortgagor) mortgages (by subordinated or second mortgage) the equity in the property it holds residual to the security that it provided under the first mortgage.

To protect their security, a consenting first mortgagee and an intending second mortgagee invariably enter into a Deed of Priority, which in essence confirms the first lender and its first mortgage has priority over the second lender and its second mortgage such that once the first lender's loan is repaid then the second lender will be entitled to repayment of its second mortgage from the residual sales proceeds. It may also contain clauses restricting further lending by the first mortgagee.

Although seemingly simple in essence, a Deed of Priority is a legal document which may contain complex terms and conditions including recourse to personal guarantees and indemnities; its purpose is to seek to confirm priority limits, ranking of securities, and distribution of proceeds of sale.

Another related document that may be required is a Deed of Forbearance, which in essence preserves the rights of a mortgagee, which has deferred taking recovery action (to provide time to rectify), to take action against a borrower and/or guarantor in the case of a default under the terms of a mortgage .

### **Caveat vs. Second Mortgage as Security for Subordinated Debt**

A second mortgage lender should protect its interest in the security property by registering its second mortgage on title of that property; however, there are several reasons why the registration of a second mortgage may not be possible, for example; where the first mortgagee does not consent.

In such cases, a second mortgagee may secure its exposure by way of a caveat registered on title to protect the title and thereby its interests under the unregistered 2<sup>nd</sup> mortgage priority; this is called an "equitable mortgage".



A caveat is an instrument that is registered against a Torrens title for the purpose of protecting an unregistered legal or equitable interest in that title by preventing the registration of any dealing that may affect the estate or interest of the caveator. Caveats are governed by Part 7A of the Real Property Act of 1900 ([Real Property Act 1900 No 25 - NSW Legislation](#)).

A registered second mortgage provides protection to the subordinated mortgagee, and in the case of default, recovery by way of Statutory power of (possession and) sale.

A Caveat does not provide this Statutory power; rather, a Judicial order for sale from the Equity Division of the Supreme Court must first be sought to enforce registration of the equitable second mortgage and thereby authorise the power of sale – this procedure, while eventually arriving at the same outcome, may incur significant cost and delays to the second mortgagee's recovery.

Other risks in relying on Caveat security for an unregistered equitable mortgage may include:

- Lapsing of the Caveat. In the case of an unregistered second mortgage, the caveat will lapse within 3 months or a specified period from registration.
- Removal of Caveat. A person with competing interest may apply to the Court to have a caveat removed. There is also the risk of a caveat being removed by fraud, ie; where the caveator is not involved.
- Where the lodgement of a caveat will constitute an event of default according to the contracted terms between mortgagor and first mortgagee. This may be in the case where a Negative Pledge forms part of the terms and conditions of a credit contract, ie; a promise or agreement not to further encumber the security property (note: Negative Pledges are not enforceable in Queensland).
- If the intention of the caveator is to prohibit registration of future dealings, ie; further encumbrance of the security property - a caveat will not prevent another, subsequent caveat from being registered to secure a further loan.
- A caveat will not prevent "tacking" by a first mortgagee as caveats do not enjoy the statutory protection of the common law rule against tacking; even if there is proper notice provided as required, there remains the risk of a dispute between senior and subordinated credit providers.

It may be further noted that in the case of a payout by an insurance company, an unregistered or equitable mortgagee may struggle to have its interest recognised.

### **The Rule against Tacking**

Tacking is where a secured lender (typically a first mortgagee), having made advances of principal to the borrower up to the limit of the credit facility, then seeks to provide additional advances to that borrower in the presence of a second secured mortgagee, while relying on its existing first mortgage security – the additional advances are "tacked on" to the existing security.

The question for the first mortgagee becomes whether, under its existing first mortgage security and in the presence of a secured second mortgagee, it can recover the additional advances "tacked on" to the original loan? Tacking could be seen as the first mortgagee trying to claim first priority for such further advances.

If the first mortgagee is secured to 70% of security property valuation, and a second mortgagee is secured to 90% of valuation, then how does the first mortgagee recover further "tacked on" loan funds?

Logically, the first mortgagee only has claim to the first 70% of valuation or the net sales proceeds and then any residual beyond the second mortgagee's 70-90%; here, full recovery of tacked-on advances becomes more risky and less likely in the case of a forced mortgagee sale where it is likely that the sales price achieved may not reflect the full value of the property.

A secured second mortgagee would typically take security over the same property as the first mortgagee and provide notice to the first mortgagee and thereby gain its consent.

Common law restricts tacking and the additional "tacked on" loan advance would then rank behind the security of the secured second mortgagee (akin to a third mortgage loan by the first mortgagee that would rank behind the secured second mortgagee with first mortgagee seeking second mortgagee's consent).



The rule against tacking is affected by legislation (Section 36(9) of the Real Property Act 1900 ([REAL PROPERTY ACT 1900 - SECT 36 Lodgment and registration of documents \(austlii.edu.au\)](#)), which is concerned with Priority) and common law with reference to foundation case law of *Hopkinson v Rolt* (1861) 11 ER 829, where the rule holds that a first mortgagee cannot claim that such future advances are tacked on to the first mortgage in priority to the second mortgagee where sufficient notice to the first mortgagee has been provided by the intending second mortgagee, thereby affecting the conscience of the first mortgagee (*Proctor* ([bransgroves.com.au](#))).

Other important case law includes *West v Williams* (1899) 1 Ch 132 and *Matzner v Clyde Securities Ltd* [1975] 2 NSWLR 293 ([07.09.12 Variation Assignment of Mortgages.pdf \(bransgroves.com.au\)](#)).

To protect its position and interests via the rule against tacking, a second mortgagee must provide notice in writing to the first mortgagee of its subsequent mortgage and the amount that it secures.

Until the first mortgagee is made aware by actual notice that a second mortgage has been granted over the security property, any further advances by the first mortgagee shall take priority over the amounts owing to the second mortgagee.

Once the first mortgagee has actual notice of another mortgage (mere registration of the mortgage will in itself not be sufficient) any further advances by the first mortgagee will rank in priority behind the amount owed to the second mortgagee.

In summary, the rules against tacking still apply despite the implementation of the *Real Property Amendment (Certificates of Title) Act 2021* and:

- a prudent unregistered mortgagee should bring its unregistered mortgage to the notice of any registered mortgagees and seek to register its priority having first ascertaining the quantum of preceding advances and therefore the value of its security.
- a prudential first mortgagee should seek to confirm its priority position (via a Deed of Priority) with intending second or subsequent mortgagees prior to making any further loan advances to the borrower.

### **The Effect of the Amendment on Lenders**

The new changes will have a significant, and possibly a burdensome, impact on lenders.

Liens and equitable mortgages that are secured by the possession of certificates of title to real property may find their security void because of the abolition of certificates of title; alternative security arrangements must be made.

Borrowers are no longer required to provide the CoRD consent of first registered mortgagees on title to subsequent mortgage registrations in PEXA, however, there is likely to be more emphasis on contractual obligation under financing arrangements.

Where there is already an existing mortgage registered on title, NSW Land Registry Services no longer monitors the registration of subsequent mortgages.

Lenders therefore face the burden of now having to monitor secured properties for any future dealings being registered without their consent or knowledge; however, there is presently no system in place to notify a mortgagee or to create an alert of future dealings - regular manual procedures may be the only way to discover the subsequent registration of any caveats or subordinated mortgages in the absence of notice.

As it is no longer necessary for an intending second mortgagee to obtain the consent of a first mortgagee, it follows that, for a first mortgagee, there is increased importance in ensuring adequate negative pledge undertakings are documented in credit contracts and security documentation and that compliance with such contracted terms is maintained for the duration of Credit Contracts (except in Queensland where negative pledges are not enforceable).



## Mezzanine Finance

Mezzanine finance is a term used in Australia mainly in the context of project finance; it refers to the funding gap between senior debt (first mortgage finance) and the total development cost of a project.

Although the term typically implies second mortgage finance for construction; by definition, mezzanine finance is a structured hybrid facility comprising both subordinated debt and an element of equity.

Mezzanine finance is subordinated to senior (first mortgage) finance but ranks in front of true equity.

Because of the high exposure level (measured by LVR) and the associated increased risk, the cost of Mezzanine finance can be high compared to more conservative senior debt.

By utilising mezzanine finance, a property development project invariably shows a higher Return on Equity despite skewing higher the project's *weighted average cost of capital*.

Mezzanine finance may be used partially or wholly in place of the developer's cash equity, it may provide part or full funding of the required developer's equity contribution that usually is applied to the financing of project soft-costs and GST and other project costs. It means that a developer's limited equity may then be spread across other projects that are being undertaken simultaneously.

A mezzanine finance facility may be structured to fully comprise subordinated debt or may provide for the conversion of the subordinated debt and/or the interest payable on the subordinated debt to equity in the borrower company or its holding company, especially on the occurrence of an event of default, or a profit share otherwise.

Although costly, if utilised wisely, mezzanine finance may bring tangible and intangible benefits to a project including but not limited to a higher Return on Developer's Equity.

## The Effect of the New Amendment on Second Mortgage & Mezzanine Finance

The new amendments to the Act do away with paper CTs and the requirement for a first mortgagee to provide consent to an intending second mortgage and produce the CT for registration of the second mortgage.

In doing so, it is now a simple and quick process for a borrower to raise extra finance to support a property purchase or development project.

Where a project may be running short of funds due to cost or time overruns or variations, a quick and feasible solution may be to raise subordinated debt via a second mortgage or a mezzanine finance facility.

Because of the amendments implemented by the new Act, an intending second mortgagee is no longer required to obtain the consent of the first mortgagee.

However, taking out a second mortgage or mezzanine finance facility may place the borrower in default with the senior financier by virtue of breaching Negative Pledge covenants in the credit contract and loan agreement.

Should the requirement for extra funds come about towards the end of a project, ie; to finance the project's completion, where the urgency to complete and on-sell the project overshadows the need to avoid first mortgagee default, it would be a judgement call decision whether or not to obtain subordinated finance, say by the security of a caveat registered on title, despite the risk of first mortgagee discovering the technical default.

In such a circumstance, it is in the best interest of all parties to complete the project and sell down to repay debt; a technical breach of the first mortgagee's contractual terms, especially where the first mortgagee will not extend further funding, may not result in an adverse reaction – at worst, penalty interest may be imposed and the project would be completed and sold down before any recovery default or recovery action can be commenced.



## Key Terms

- *Weighted Average Cost of Capital* means the average cost of the various sources of debt + equity weighted by proportion. It's calculation weights the cost of each source by constituent proportion, which provides a clear final cost of funds used in feasibility and loan serving calculations, for example.

The calculation is done by multiplying the cost of each capital source (debt and equity) by its relevant proportion of the total, and then adding the sources' costs together to determine the weighted average.

- *Certificate of Title (CT)* means a paper copy of a folio of the NSW Torrens Land Register. The Certificate of Title records the name(s) of the current owner(s), land description including lot and plan number, and any other registered interests on the title such as mortgages, easements and covenants.
- Control of Rights to Deal (CoRD) means where a party has authority to consent to the registration of a subsequent interest in land. For example, if land is to be mortgaged, the intending mortgagee, such as a bank, would hold a CoRD to effect and record its mortgage or to allow a second mortgagee to register its subordinated mortgage.
- *Electronic Lodgement Platform* means an online system for the preparation of electronic dealings and their lodgement with NSW Land Registry Services.
- *PEXA* means "Property Exchange Australia" and is an online system (electronic lodgement platform) for lodging electronic registry instruments operated by a company (Pexa Group Ltd) listed on the ASX.
- *Mortgage* means a transfer of the legal estate in land for the purpose of securing a debt.

Once a property is mortgaged, the mortgagee becomes the legal owner of the property and the mortgagor holds the equity of redemption, ie; legal ownership will be re-transferred on the discharge of the secured obligations.

A legal mortgage is the most secure and comprehensive form of security interest; it is typically recorded against the title of the property that has been pledged as security (mortgaged). A registered mortgage has priority over an unregistered mortgage.

- *Caveat* means a statutory injunction that prevents the registration of dealings and plans on a title under the Real Property Act 1900. Once a caveat is recorded it must be removed, or the caveator's written consent obtained, before any new dealings can be registered relating to the property.

A caveat records a claim for a legal or equitable estate or interest in land and is used to protect interests in land. It also acts as a "freeze" on the subject property and prevents anyone else registering a dealing with that property that may be contrary to the interest of the person who lodged the caveat. Therefore, a caveat gives notice to the world of an interest in land.

Once a caveat is lodged in NSW it remains effective until it is withdrawn (either by the caveator or court order) or until it lapses.

A caveat must not be lodged without reasonable cause; any person who lodges a caveat without reasonable cause may be liable for damages.

- *Priority* means "whose interest prevails and which interest is to be satisfied first?"

General law priority disputes are governed by a series of rules which apply to different categories of proprietary interest. These rules are partially applicable to Torrens land; however, overriding all other interests is the act of registration of a mortgage, for example.

Registration may be seen as conferring the highest level of priority possible to accord to an interest because registration confers the legal interest 'free from all other encumbrances'. As the general law priority rules are modified by the Torrens legislation, it remains important to identify the nature of the competing interests when assessing which would prevail.



- *Negative Pledge* means a provision in a credit contract which prohibits the borrower from creating any security interests over certain property specified in the provision.

It is an undertaking by the borrower to the lender not to create or permit security or otherwise encumber certain of its assets without the prior written consent of the lender.

The purpose is to prevent the borrower from taking on future debt that could compromise its ability to meet its obligations to the existing lender.

Violating a negative pledge clause can trigger a default on the loan, albeit a technical default and lenders generally give an allotted amount of time, typically 30 days, to remedy a covenant breach before progressing with default procedures.

- *Tacking* means where a secured creditor, having advanced funds to a borrower in accordance with its security documents, subsequently provides additional advances to that borrower, relying on its existing security to secure repayment of those advances and the ability of that lender to secure the additional advanced funds advances (new loans) under existing security which rank in priority to any amounts subsequently lent by, and secured in favour of, another lender, eg; a second mortgagee. Tacking is governed by the Rules Against Tacking which are based on the principle of Priority.
- *Return on Developer's Equity* means the return after a completed project has been liquidated and GST has been paid, together with all sales and marketing costs and commissions. This return is divided by the developer's cash equity contributed; it is a measure of return-on-investment made by the developer, ie; on the developer's cash contribution; it is akin to the return for depositing cash at bank.

## Closing Notes and Key Takeaways

The NSW Government has legislated an amendment to the *Real Property Act of 1900*, the amendments are effected by operation of the new *The Real Property Amendment (Certificates of Title) Act 2021* which came into effect 11 October 2021.

The new amendments have abolished paper certificates of title and CoRD authorities in favour of a fully digital platform.

These new amendments also mean a first mortgagee no longer is required to produce title in order for a second mortgagee to register its priority, therefore; an intending second mortgagee is no longer required to seek the consent of a first mortgagee.

Raising second mortgage or mezzanine finance to complete a property development or to upgrade or even purchase a property has never been easier as a result of the NSW government's drive to a fully electronic settlements platform.

That being the case, the rules against tacking still apply, a short delve into the principle of priority necessitate that a subordinated lender (second or subsequent mortgagee) must give notice to avoid its security being eroded. An intending subordinated mortgagee must also register its priority to safeguard its security and its claim to recovered funds in case of a default.

## Further Reference Material

[Abolition of Certificates of Title | Registrar General \(nsw.gov.au\)](https://www.nsw.gov.au/abolition-certificates-title)

[NSW Land Registry Services guide on electronic leases](#)

[Registrar General's Guidelines](#)

[Microsoft Word - 06. Priorities.doc \(jaani.net\)](#)

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