

10 NOVEMBER 2016

REAL ESTATE ALERT

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The unconstitutional nature of s118(3) of the Local Government Municipal Systems Act, No 32 of 2000 (Act).

The anxiety surrounding a purchaser's liability for historical debt has finally been appeased in the recent High Court judgment handed down on 7 November 2016, which for the sake of brevity will be referred to as the *Municipality* case, wherein the court held that s118(3) of the Act was unconstitutional and therefore purchasers could not be held liable for the historical debt of sellers.

As a quick refresher, the Act allows municipalities two distinct remedies to claim monies in respect of arrear rates, namely:

- the municipality could either prohibit the transfer of property altogether by not issuing a clearance certificate until all debts for the past 24 months have been settled (as per s118(1) of the Act); or
- the municipality could submit a claim as a secured and preferred creditor, which claim ranks in priority to that of any bondholder over the property (as per s118(3) of the Act).

In the case of *City of Tshwane Metropolitan Municipality v PJ Mitchell* [2015] ZASCA 1 (29 January 2016), the Supreme Court of Appeal held that the municipalities rights in terms of s118(3), being akin to a "charge upon the property" survives transfer (regardless of the originating cause of such transfer) and that there is no limitation on its duration (unlike s118(1) which is limited to a period of two years). It is this second remedy which would allow the municipality to attach a property and subject it to a sale in execution, and it is in this sense that the purchaser, as owner of the property, could be said to be liable for the historical debt.

The interpretation of s118(3) by the majority in the *Mitchell* case raised both the eyebrows and the ire of potential purchasers, financial institutions and attorneys. It was clear that the constitutionality of s118(3) had been called into question.

In the *Municipality* case, five different applications against two different municipalities were heard together. The argument put before the court by the applicants was simple: "Section 118(3) is invalid and unconstitutional in that it burdens the new owner with the municipal debts incurred by the previous owner, consumer or tenant." In other words, the debt of an old owner cannot be transferred to a new owner, unless there has been an agreement to this effect. To allow for the transfer of debt without such an agreement is a violation of the right to property which is unsupported by sufficient reason.

In response, the municipalities contended that:

- the constitutional challenge had been prematurely invoked (especially where the municipality does not seek to perfect its security); and
- the purpose of s118(3) is to secure payment of municipal debts by using the property as security, regardless of who the current owner is.

One of the municipalities conceded that s118(3) does amount to deprivation, but that the deprivation is not arbitrary and is supported by the reason that it exists to recover municipal debts in the interest of

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The judgment has therefore restored certainty for purchasers and financial institutions by placing an obligation on municipalities to timeously exercise remedies at their disposal.



the community as a whole, and to ensure that the municipalities remain economically viable and sustainable.

In arriving at its decision, the High Court analysed the arguments made by each party and applied the necessary tests to these arguments, which we will consider in greater detail in a separate Alert. In short, however, the court held that:

- there must be a relationship between the deprivation created and the property or its owner. In other words, there must be a link between the enforcement of s118(3) and the owner and the property. In this instance, and given the context, the court held that it did not believe that reference to "owner" should include successors in title, as there is no relationship between them, the property and the debt incurred.
- to simply state that there is always a link with the property is not entirely correct as the deprivation in this instance (ie perfection in terms

of s118(3) of the Act) results in a complete deprivation of all rights of ownership, and not simply a limitation/interference with of a single right; and

- transfer of the property to a purchaser does not cause the purchaser to be a co-debtor, but rather the purchaser is now simply in possession of the item which serves as security for the debt, ie the property. Furthermore the municipality has sufficient recourse against the seller, while the property is registered in the seller's name and to allow for the municipality's right to survive in eternity is to apply the section "indiscriminately and far beyond what is necessary".

The judgment in the *Municipality* case has therefore restored certainty for purchasers and financial institutions by placing an obligation on municipalities to timeously exercise remedies at their disposal.

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2017 Edition**

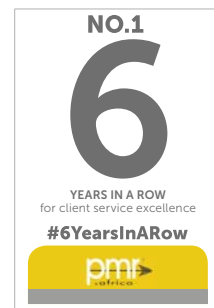
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