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ALERT

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Commercial property loan finance: Using a long-term lease as security

In terms of the Deeds Registries Act, a registered long-term lease agreement constitutes immovable property which is capable of being mortgaged as security for a loan or other debt.

The registration of a long-term lease agreement in the Deeds Office is important for the enforcement thereof against the creditors and successors in title of the lessor, as section 1(2) of the Formalities in Respect of Leases of Land Act 18 of 1969 provides that:

> *"No lease of land which is entered into for a period of not less than ten years or for the natural life of the lessee or any other person mentioned in the lease, or which is renewable from time to time at the will of the lessee indefinitely or for periods which together with the first period of the lease amount in all to not less than ten years, shall, if such lease be entered into after the commencement of this Act, be valid against a creditor or successor under onerous title of the lessor for a period longer than ten years after having been entered into, unless*:
>
> (a) *it has been registered against the title deeds of the leased land; or*
>
> (b) *the aforesaid creditor or successor at the time of the giving of credit or the entry into the transaction by which he obtained the leased land or a portion thereof or obtained a real right in respect thereof, as the case may be, knew of the lease."*

The registration of the lease is also required for the long-term lease agreement to constitute immovable property in terms of section 102 of the Deeds Registries Act 47 of 1937 (Deeds Registries Act), which provides that "immovable property" includes:

> *"...any registered lease of land which, when entered into, was for a period of not less than ten years or for the natural life of the lessee or any other person mentioned in the lease, or which is renewable from time to time at the will of the lessee indefinitely or for periods which together with the first period amount in all to not less than ten years."*

In terms of the Deeds Registries Act, a registered long-term lease agreement therefore constitutes immovable property which is capable of being mortgaged as security for a loan or other debt.

In order for the long-term lease agreement to be registered in the Deeds Office, the lease would first need to be notarially executed by the parties and then registered in the relevant Deeds Office in which the leased property is registered in the name of the lessor.

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AVOIDING POTENTIAL PITFALLS

The registered notarial lease agreement may contain certain restrictive provisions regarding the rights of a lessee to register a mortgage bond over the lease agreement. For example, the lease could require that the lessor's written consent be provided in order to mortgage such lease agreement.

There may also be other restrictive conditions which could affect the bank's security, such as conditions regarding the permitted use of the property.

The bond holder's rights would, however, also be subject to the continued existence of the lease agreement and the security afforded by the mortgage bond would therefore come to an end upon the cancellation of the lease agreement unless the bond holder's rights are protected.

The relevant financial institution could therefore require the conclusion of a tripartite agreement between the financial institution, the lessor and the lessee, affording the financial institution certain *"step in rights"* in the event of default, the cancellation or termination of the lease agreement.

In terms of a tripartite agreement, the financial institution could be afforded an option to lease the relevant property and to cede and assign its rights in respect of the option to a third party or to nominate a third party to exercise the option in its place and stead.

In order to avoid potential complications and delays down the line, it is advisable for a prospective borrower to determine the financial institution's requirements at the outset and to ensure that it is familiar with any restrictive provisions contained in the relevant lease agreement intended to be mortgaged.

It would also be advisable for the borrower to then first confirm that the lessor is in fact prepared to provide a consent or to enter into a tripartite agreement (if applicable and required by the financial institution) before proceeding with any loan finance involving the mortgaging of a lease agreement as security.

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