PROPERTY LAW FOR HOUSING LAWYERS

SALE AND RENT BACK SCHEMES

(or 'Birmingham 1 Leeds 2 (at half time)')

Outline

1. What is a sale and rent back scheme?

1.1 The basic scheme involves two transactions: a sale of the freehold of a property, and a tenancy granted back to the seller.

1.2 But this is almost invariably complicated by a third transaction: a mortgage.

2. This has been a common arrangement in the commercial sphere for some time, where a sale and leaseback transaction may be entered into for financial, accounting and/or tax reasons.

3. The use of such an arrangement in a residential context – at least on a systematic basis – appears to have developed much more recently: perhaps only towards the middle of the current decade. The OFT estimated that, by around mid-2008, there had been around 50,000 sale and rent back transactions, although there are no reliable statistics.

4. In substance, they are a more extreme version of a "home reversion plan", which is a form of 'equity release' product under which a homeowner (usually of retirement age or older) sells all or part of their interest in their home, in return for a right to live in it as a tenant until they die or move out (to a care home) or until the end of the fixed term is reached (at least 20 years for a regulated plan). Home reversion plans have been regulated by the FSA since April 2007.

5. Sale and rent back schemes have often been targeted at homeowners in financial difficulties, who are offered the prospect, e.g., of releasing equity from their homes to write off debts, or of dealing with arrears on debts secured on their homes, whilst continuing to live there.

6. The attractions when compared with selling up and moving on may be obvious – e.g. wishing to remain in a long-standing home, avoiding the upheaval of moving out or of affecting children's schooling arrangements – or less obvious (such as

'confidentiality' - avoiding having to reveal financial difficulties to family and friends)[1].

7. Many of those who have entered into these schemes are happy with the outcome, and it may be the best option for some, particularly for those who are able to stay whilst lowering their monthly outgoings on a sustainable basis. But there are also many who have suffered significant detriment as a result, and for whom other options would have been more appropriate.

8. Since 30 June 2010, these schemes have been regulated by the FSA under a full regime of regulation, an interim regime having been brought into effect a year earlier.

9. They continue to be offered, but current market conditions and limitations on mortgage finance may well have reduced the number of new transactions considerably.

10. The potential problems with these schemes, which led to their regulation, are many and various. Just a few examples will illustrate this:

10.1 The sale is usually at a discount to market value. Sometimes the discount is very substantial, and far in excess of any discount justified by the existence of the proposed tenancy.

10.2 The tenancy to be granted may not be explained accurately, or properly understood by the seller. The 'mis-selling' may be deliberate, reckless, or through ignorance, tempered (at least until the financial crisis) by optimism and an element of failure to appreciate the 'pyramid' nature of some of the schemes (particularly those involving supposedly discounted rents).

10.3 Homeowners may be led to believe that they can continue to live in their homes as tenants "for life", and perhaps even that their children will be able to do so too, but in situations in which that is either untrue, or conditional, or not properly or validly reflected in the legal documentation.

---

[1] The OFT also noted others, such as where the homeowner was too ill to move, and (more mundanely) where it was feared that pets could not be moved into rented accommodation.

10.4 Other promises may be made – e.g. cash back at a later point, buy back rights, or a right to share in any increase in value of the property – which may turn out to be legally or practically unenforceable.

10.5 The purchase is ordinarily financed with the assistance of a mortgage. Any form of tenancy other than a short AST will not usually be permitted by the mortgage deed, and the mortgagee is unlikely to accept that it is bound by it.

10.6 Owners may be recommended to solicitors who do not look after the owners' best interests, or ensure that the owners truly understand the risks involved in the transaction.

10.7 The financial naïveté or inexperience of the homeowners, or the financial pressures which they are experiencing, can lead them to enter into transactions which are significantly to their financial detriment, without appreciating that, and without understanding the other options that may be available to them. In one case I have dealt with – Redstone Mortgages v Welch & Jackson [2009] 3 EGLR 71 ("Redstone") – the mortgage arrears were only around 4 months, and might very well have been addressed fairly easily between the Jacksons and their mortgagees, but they simply did not appreciate that.

10.8 The transactions may lead to difficulties for the seller/tenant in obtaining housing benefit for the new tenancy or in being re-housed in the event of lawful eviction.

10.9 There are serious questions over the viability and sustainability of some of the business models adopted by sale and rent back firms, at least without significant financial detriment to homeowners[2], particularly since the credit crisis. This has led to some significant failures (e.g. North East Property Buyers, of whom more below).

---

[2] This may not be true generally, however. The OFT commented in its Market Study, at paragraph 4.33, that: "*Our conclusions is that sale and rent back is potentially a viable proposition in the sense that it can be profitable for the firm to supply at the same time as delivering the benefits consumers expect. However, at present consumers bear a great deal of risk ...*" They refer later to the level of risk as "*unacceptable in terms of most consumers' ability to take account of those risks at the time of purchase .... but also by comparison with the levels of risk associated with other regulated products*" (paragraph 11.3)

11. In short, these schemes <u>can</u> seem to be a panacea for all forms of financial difficulties; but in the wrong circumstances they can lead to homeowners both losing all or much of the value in their homes, and becoming homeless.

12. FSA rules and regulation (see below) <u>may</u> lead to fewer unacceptable practices, but there are likely still to be cases where the provider is operating unlawfully or where a licensed operator fails to comply with its statutory duties. And regulation can only go so far: even in relation to regulated schemes, the advice in the prescribed consumer factsheet which must be given those thinking of getting involved in such schemes may fall on deaf ears, even though it includes the following firm warnings:

> *"You may be tempted to consider these schemes of you are having problems paying your mortgage. In this kind of scheme, you sell your home at a discounted price and in return you stay living there as a rent-paying tenant for a fixed term. This may allow you to clear your mortgage and other debts, but you will face new risks*
>
> ***Risks of sale-and-rent-back schemes***
>
> - *You will no longer own your home.*
> - *You may still have to leave your home after the fixed term of your new tenancy agreement.*
> - *Your rent could go up both during and after the fixed term of your tenancy.*
> - *You could still be evicted during the fixed term if you breach the terms of your tenancy, for example if you fall behind with your new rental payments.*
> - *The amount you get for your home will be much lower than its price if you sold it normally.*
> - *If the person or firm buying your home gets into financial difficulties, the property could still be repossessed and you might have to leave.*
> - *If you sell your home at a discounted price, this may affect your eligibility for bankruptcy or other forms of insolvency.*
>
> ***Consider these schemes only as a last resort.***
>
> *Make sure you have looked at all other options first."*

<u>Legal analysis of these schemes</u>

13. It is convenient to analyse the two aspects of these schemes – the sale/tenancy and the mortgage – separately. This is partly because the seller/tenant's rights against a mortgagee may be very different from his rights against the buyer.

14. The situation may involve various questions of contract law, conveyancing law, land law, landlord and tenant law, equity, and the law of mortgages.

15. As there are still many unregulated transactions in existence, I shall not seek to distinguish between regulated and unregulated situations. The former ought to involve fewer problems – and give rise to fewer potential rights of action – but to expect perfection is unrealistic.

The sale and the 'rent back'

16. The sale will in many respects be a fairly normal form of sale.

17. The buyer may be a partner in a business organisation operating this type of scheme, or (often) a nominee for such an organisation.

18. However, the price is likely to be at a discount from the open market, vacant possession value:

18.1 Sometimes the price payable is the net, discounted price.

18.2 On other occasions, the price is at, or much closer to, full market value with vacant possession, but a part of that price is then dealt with in some other way – perhaps repaid to the buyer, or paid to a third party, or just simply not paid.

19. In itself, a discounted price may be appropriate and acceptable, either as a profit to the buyer to reflect risk being taken on, or as a reflection of the effect which the new tenancy will have on the market value of the property, or both. But on too many occasions, much more of a discount seems to have been involved, and the true situation may not have been properly explained, or may have been misrepresented, to the seller.

20. Promises may also have been made as to various incentives, such as a buy-back option, or the right to the return of part of the difference between the market value and the discounted price, if certain conditions are complied with (e.g. if the tenant remains in occupation of the property and has paid the rent promptly for a defined period). These may not be documented, may be of doubtful effect, or may prove to be unenforceable due to the buyer's own financial difficulties.

21. The second part of the transaction is the 'rent back': the granting of a tenancy by the buyer back to the seller. This may, or may not, be something which forms part of, or is mentioned in, the contract of sale.

22. Even if the sale price is not tainted by any wrongdoing or irregularity, problems may still arise in relation to the tenancy. The problems may be many and various, but some common problems are these[3]:

23. A tenancy "for life', or something similar, may have been promised, but the tenancy granted will rarely have that effect; or, at least, will not do so unless all sorts of contingencies are satisfied.

24. The tenancy may, in law, be only an assured shorthold tenancy (either expressly or by default), but this may not be clear to the seller/tenant, or they may not understand the effect of this.

25. The fixed term of the tenancy is often relatively short – 1 or 2 years, or even less – leading to a risk of termination much sooner than the seller/tenant realises, especially if the tenancy is an AST.

26. There may or may not be a discounted rent, but any discount is unlikely to last in practice much beyond the fixed term. This may not be understood by the seller/tenant. They may end up paying more in rent than they were paying towards their mortgage and other debts, with the result that (even with an assured tenancy) they find themselves facing a claim for possession under the Housing Act 1988 on mandatory grounds. In some cases, substantial rent increases have been demanded (legitimately or otherwise) fairly soon after the tenancy is granted.

27. Inadequate or inappropriate documentation may lead to no tenancy, or only a relatively precarious tenancy (such as a tenancy at will) being granted. The more that has been promised, the greater the risk of this happening: e.g. a genuine form of life tenancy can only be created by deed (LPA 1925 ss.52(1) and 149(6)).

28. The starting point in analysing the effect of these schemes between the homeowners and the buyers is to identify what promises and agreements were

---

[3] See also the facts and allegations summarised in Appendix 2 to the judgment in the NEPB case.

made (and in what form), what transactions have actually taken place, what rights have been granted back to the homeowners, and what rights and claims the homeowners now have as a result.

Promises

29. Promises will often have been made, both orally and in writing, which fall short of forming part of any more formal agreement.

Agreements

30. There will almost always have been a written contract of sale, although this may not have been properly signed.

31. There may also have been other agreements along side it: e.g. an agreement to grant a tenancy, an agreement as to how the discount on the purchase price is to be dealt with, an agreement regards for re-purchase (if the homeowner is to be allowed to buy back the property in certain circumstances), or a 'side agreement' affecting the tenancy.

32. The terms, validity and effect of each of these will need to be considered.

33. That might need to extend to identifying what proprietary rights may have arisen from those agreements, particularly where third party rights may be involved (e.g. a mortgagee) or where the buyer has been made bankrupt or is in insolvency liquidation.

34. That might also extend to whether they have an effect on any separate promises or misrepresentations that may have been made – e.g. whether there are exclusion or limitation clauses – subject to the statutory limitations on such clauses (under, e.g. the Unfair Contract Terms Act 1977 or the Unfair Terms in Consumer Contracts Regulations 1999).

35. In addition, the situation may be sufficiently strongly adverse to the homeowner for the transaction to be regarded in equity as an 'unconscionable bargain'[4], but this is not likely to be easy to establish.

---

[4] For the requirements for this, see the brief explanation in Halsbury's Laws of England, 4th edition, Vol. 31 ('Misrepresentation and Fraud'), para.854. More detailed consideration can be found in Snell's Equity (31st edition), paragraphs 8-045 to 8-050, Jones v Morgan [2001] EWCA Civ 995 at [32] and [35], and Cresswell v Potter (1968) [1978] 1 WLR 225n.

Creation/transfer of proprietary interests

36. There will be a transfer, and there should also be the grant of a tenancy, although issues may arise as to the effectiveness of the latter. There will also, usually, be a mortgage: see below.

37. The timing of these transactions may be important when it comes to considering the position of the mortgagee, but as between homeowner and buyer, the issues are likely to concern the effect of the various promises and agreements, including the tenancy agreement.

Rights granted back

38. The nature of the rights granted will depend to a large extent upon the promises and agreements

39. In particular, the form and effect of the tenancy agreement may be a significant issue.

40. In many cases, it is likely clearly to be in AST form, without any room for argument on the part of the tenant. In other cases there may be room to find that it is an assured tenancy (as in Redstone).

41. It might in rare cases be possible to find a fixed term tenancy of many years' duration, or tenancy 'for life' (which will take effect as a term of 90 years terminable after death: LPA 1925 s.149(6)), but to be effective in law these will need to have been created by deed – LPA 1925 s.52(1) – and will need to be registered under the LRA 2002.

42. On the other hand, the form of the document might not give rise to any tenancy at law at all: e.g. because there is no deed, and the tenancy[5] does not satisfy LPA 1925 s.54(2) (tenancies for a term of three years or less "*at the best rent which can be reasonably obtained without taking a fine*"[6]). That might still leave an agreement in place which can take effect as an agreement to grant a tenancy in equity (and so, in effect, an equitable tenancy), but that may be of less assistance as against a mortgagee: see below. Moreover, the tenancy agreement may not even give rise to a tenancy in equity: e.g. if the tenancy (if granted) would not

[5] Or, indeed, any periodic tenancy which may have arisen as a result of the payment of rent.

[6] And it is arguable that a discount on the sale price might amount to a "fine", particularly if the rent is at less than market rent.

satisfy LPA 1925 s.54(2), then the agreement may not give rise to any tenancy in equity either, because there is no single document (or exchange of documents) signed by both parties and/or no such document containing all of the terms agreed: both are requirements for a valid agreement to create an interest in land (other than a s.54(2)-compliant tenancy) under the Law of Property (Miscellaneous Provisions) Act 1989 s.2.

43. In some cases, you may find that the best available possibility is a tenancy at will: that could still be protected under the Housing Act 1988, but would not give any better rights than that.

44. In practice, the greater the rights promised, the greater the risk that there will be problems for the seller/tenant arising from the form of the documentation.

45. Sometimes, the 'tenancy' may have been agreed on a rent-free basis, or at a very low rent, which may as a result take it wholly outside the protection of the Housing Act 1988. In that event, a tenancy which is easily terminable at common law, or which has only a short duration, could leave the former homeowner with the most precarious rights to occupy.

46. This illustrates that there may be much work to be done just to establish something better than an AST, or even just an AST. Without some sort of effective right to occupy, the seller/tenant will be in a very difficult position, and the only option[7] may be to try to establish some form of estoppel and/or to try to set the transaction aside: see below.

47. Other rights may also have been granted as part of the transaction (e.g. in relation to incentives (see above). The enforceability of these rights may also need to be considered – and some relief claimed before it is too late – but they will not usually have a direct effect on the seller/tenant's rights to occupy their home.

Estoppel?

48. If promises were made as to the nature of the rights to be granted, or as to additional rights to be granted, then it is possible that the promised rights (or

[7] Apart from insisting that the requirements of the Housing Act 1988 be complied with, and relying on the limited rights given by the Mortgage Repossession (Protection of Tenants etc.) Act 2010.

something similar) may instead be obtained by way of a proprietary estoppel. There might also be defences by way of other forms of estoppel, e.g. promissory estoppel.

49. The effectiveness of such claims/defences will depend on the usual principles applicable to each form of estoppel, but I raise an additional word of caution: issues may arise as to the limits on estoppel in relation to statutory protection under the Housing Act 1988. No such issues were raised in Redstone (in which, for example, a restriction to only certain Schedule 2 grounds for possession as a result of estoppel was, in practice, conceded), but that should not be taken as confirming that no such issues exist.

50. When the position of the mortgagee comes to be considered, the merely equitable nature of estoppel rights and defences may also be of some importance.

Rights of action that may also be available

51. Rather than enforcing the transaction, the seller/tenant may prefer (or need) to try to unravel it, and it may be possible to do this.

52. In particular, there may be a right to set the transaction aside on some ground. The most likely grounds are misrepresentation and, perhaps, that the whole transaction amounts to an unconscionable bargain. There might also be room for a claim of undue influence. A word of warning, however: setting aside will require restitution on both sides, and the seller/tenant may either be unable to give restitution at all, or may be unable to raise the funds necessary to be able to do so. In Redstone, the judge determined that restitution should be given on terms that were favourable to the sellers/tenants, taking into account their circumstances and the role of the transaction in creating those circumstances, but that will not always be the case; and they still had to accept (among other things) a mortgage in the amount repaid at the time of completion of the transaction[8].

53. There may also be rights to claim damages – e.g. for misrepresentation or negligence – but the utility of such claims will depend on the extent to which the

[8] In the end this was achieved by granting a mortgage in favour of a new lender, with the proceeds being paid over to Redstone by way of this part of the required restitution.

buyer (or anyone else involved in the transaction) is able to satisfy a claim for damages. Any solicitor who may have acted (or purported to act) for the seller/tenant may be the only potential defendant against whom an award of damages may be enforceable in practice; but that may provide little comfort if this does not put the seller/tenant in a position to remain in his home.

54. In relation to transactions entered into since these schemes were regulated, there may well also be other forms of redress, some of which may prove to be rather more effective than the common law or equitable remedies: see below. Claims against the scheme provider may also be satisfied (at least in part) from the Financial Services Compensation Scheme.

55. In many cases, so long as care is taken not to elect too early for one particular right of action or remedy, or to affirm the transactions (leading to the loss of any rights which may still exist to set it aside), it may also be possible to keep various alternatives open until fairly late in the day: in Redstone, the sellers/tenants were given a period of time after judgment within which to make their election between alternative remedies (which was, in part, going to depend on the extent to which they could obtain a new mortgage, and for how much).

The mortgage

56. These schemes are likely to be financed with borrowed money. Usually, there will be mortgage finance, obtained on a 'buy-to-let' basis.

57. In many of the pre-regulation schemes, this may well have been obtained without the mortgagee being aware of what has gone on: indeed, both the mortgagee and the former homeowner may have a firm basis for asserting that the whole scheme was a fraud on both of them. In a regulated scheme, the mortgagee's written consent is required both to the letting and to its terms, although in current circumstances, this is likely to be given only to an AST.

58. If and for so long as the buyer continues to service the mortgage, the mortgagee may well remain unaware of any breach of the limits on permissible lettings (or, possibly, unconcerned by it), and on a practical level the seller/tenant's rights may be unaffected by breaches of the mortgage conditions. But that is not necessarily the case.

59. Of greater concern is what happens if the buyer defaults on its mortgage, and the mortgagee seeks to repossess the property. If the mortgagee is not bound by the tenancy, or by any other rights of the seller/tenant, then there may be little that the seller/tenant can do to oppose a possession order: the seller/tenant may then be left only to pursue whatever financial remedies he can obtain against the buyer or his own solicitor.

60. Some early grounds for optimism on this issue were generated by a decision at county court level – in Birmingham County Court – that the buyer/tenant's rights might prove to be protected in situations involving sale and rent back schemes (Redstone). Birmingham 1.

61. However, the law has recently been decided the other way by another circuit judge, this time sitting at High Court level in Leeds: the North East Property Buyers' case [2010] EWHC 2991 (Ch)[9] (the "NEPB case")). Leeds 2.

62. The Court of Appeal is now likely to have to resolve this, so the half-time score line may yet be reversed, although the Birmingham line has received a considerable knock and will have to come back from behind.

63. The additional issues between the seller/tenant and the mortgagee concern priority: or, in simple terms:

63.1 Does the tenancy bind the mortgagee?

63.2 Do any other relevant rights (such as estoppels or rights to set aside the transaction) bind the mortgagee?

64. There are five main ways in which priority might be established[10], assuming that the case concerns registered land[11]:

64.1 If the mortgagee has agreed to be bound. This is unlikely to have happened in most cases[12].

64.2 If the mortgage terms permit the granting of the type of interest in question. This is unlikely to apply to any interest other than (if at all)

---

[9]Judgment was handed down on 19 November 2010.

[10] For more detail, see Fisher & Lightwood's Law of Mortgage (13th edition, 2010), paragraphs 29.20 to 29.27.

[11] It will now be a rare case in which the priority rules applicable to unregistered land may have a bearing on this.

[12] It can also arise at a later stage, including by implication, if rent paid and is received with knowledge of the tenancy: see Fisher & Lightwood, paragraph 29.27.

some form of fairly short AST, at least under the sort of standard mortgage terms in current use[13]. Even this may require the mortgagee's prior consent.

If only a fairly short AST is expressly permitted (with or without consent), then this is unlikely to assist the seller/tenant: if only a short AST has been granted, then he is unlikely to be able to obtain more than a temporary reprieve; but if he has better rights than that, then they are unlikely to be permitted under the mortgage.

64.3 If there is a basis for the mortgagee being bound to honour the seller/tenant's rights in equity under a constructive trust. This is unlikely to be realistic in most cases.

64.4 It is also possible that there may be mortgagees who may find themselves bound through having, in effect, 'waived' their priority in equity in favour of the seller/tenant's interests. The availability and scope of this possibility has yet to be tested in this context, and it is again unlikely to be realistic in most cases.

64.5 Perhaps most importantly for the 'ordinary' case – if the interest in question takes priority over the mortgage pursuant to the priority rules in the Land Registration Act 2002 ("LRA 2002"). This is considered in more detail below.

65. So far as all of those possibilities other than the last are concerned, all too many unregulated cases appear to have involved one (or both) of two things, which will not assist the seller/tenant:

65.1 the buyer has failed to reveal the true situation to the mortgagee (particularly as regards either the price, or the nature or terms of the tenancy, or the fact that there is to be a tenancy granted back to the seller who is already in occupation); and/or

65.2 the buyer has promised the seller/tenant, or led the seller/tenant, to believe that he will have greater rights than are actually granted.

66. Positively inaccurate statements in mortgage applications – or statements that are 'economical with the truth' – may also have been made. For example, the

---

[13] These are very likely to amend the default provisions about lettings by mortgagors which are laid down in the Law of Property Act 1925, and are likely to cover permitted lettings (if any) comprehensively.

mortgage company may simply have been told that the price is the full open market value of the property, even though that is not what the seller is actually going to receive[14].

67. Alternatively, the sale may be structured in two stages[15] (possibly without the knowledge of the seller): a nominee for the scheme 'provider' buys from the seller/tenant at a discounted price, but then sells on to the scheme provider straight away at full open market value. The provider obtains a mortgage against the full value of the property (probably without reporting the earlier transaction to the mortgagee). In this situation, the mortgage money is likely to be used to pay the original purchase price.

68. Indeed, I suspect that in some cases involving discounted prices (at least before the financial crisis), the discount will have had the result that the mortgage funds exceed the amount which is payable to the seller/tenant, leaving the 'provider' of the scheme needing to find no money to finance the purchase, and potentially releasing a (sometimes substantial) lump sum in cash at the outset. This is a common aspect of mortgage fraud cases, and is likely to be something which ought to have been disclosed to the mortgagee.

69. The solicitors for the buyer may have been complicit in some way, or simply negligent. Similarly, the solicitors for the seller may also have contributed (consciously or not) to the mortgagee having the impression that there was nothing unusual about the transaction.

Priority under LRA 2002

70. If the arguments over priority are limited to the final possibility (which they will be in most cases), then any actual or constructive knowledge of the seller/tenant's rights on the part of the mortgagee will not be relevant, except to the limited extent provided for under the LRA 2002 itself.

71. There are essentially two main routes to giving the seller/tenant's rights priority which either have been, or are likely to be, tried:

71.1 Establishing priority in accordance with the generally applicable priority rules.

---

[14] The situation in the Redstone case, where a large proportion of the 'purchase price' was paid to a company connected with the buyer.

[15] Which appears to have happened in one of the cases before the court in the NEPB litigation.

71.2 Establishing priority during the so-called 'registration gap'. This applies, if at all, only to a limited category of tenancies.

72. Use of the general priority rules involves two possibilities:

72.1 An earlier equitable interest in favour of the seller/tenant might be given priority over a subsequent interest in favour of the mortgagee.

72.2 The approach to a simultaneous purchase and mortgage in Abbey National plc v Cann [1991] 1 AC 56 might be applied more widely and in such a way as to give priority to the seller/tenant's interests over those of the mortgagee.

73. Both routes depend on being able to show that the seller/tenant's interest is an 'overriding interest' under LRA 2002 Schedule 3. This is likely to be possible in the normal case where the seller/tenant is already, and at all times remains, in occupation of the property, as that will enable any proprietary interest to be treated as an overriding interest under paragraph 2 of Schedule 3[16]. For this purpose, rights arising by way of proprietary estoppel are now likely to count as proprietary interests[17] – LRA 2002 s.116 – and it was accepted in Redstone that a right to set aside counted as a "mere equity" within the meaning of that provision[18].

74. The former route suffers from a number of potential difficulties, both of analysis and application, but the latter route was successful in Redstone, in which there was no challenge to the argument that the right to set aside the transaction, and rights arising by estoppel, were within LRA 2002 Schedule 3 paragraph 2.

75. However, a very different, and more conservative, view has been taken recently by another circuit judge, HHJ Behrens[19], in the NEPB case. He heard preliminary issues concerning general questions of priority, and was not persuaded by either route. An appeal is anticipated, so it remains to be seen how the Court of Appeal will deal with this. In the meantime, the NEPB case will be binding at county

---

[16] An unregistrable tenancy granted before a mortgage may also be an overriding interest under Schedule 3 paragraph 1.

[17] Although there may be room for debate as to the point at which "*the equity arises*" within the meaning of s.116, particularly where (as here) the timing of this may be critical.

[18] There may be room for debate on this, including as to the extent to which a "mere equity" needs to be, and can be, "proprietary" in some way. On "mere equities" see Snell on Equity, para.2-05 and the cases there cited.

[19] Despite approval of at least part of the analysis in Redstone by another circuit judge, HHJ Purle QC, sitting in the High Court in Birmingham in Delaney v Chen [2010] EWHC 6 (Ch).

court level, although I am aware that there are many cases which have been stayed or are simply not proceeding, pending final determination of the preliminary issues in the NEPB case.

76. The NEPB case suggests, contrary to Redstone, that the previous authorities are strongly against the seller/tenant's argument. That is certainly arguable, and may turn out to be right, but it does assume that there is only one approach to the interpretation and application of the authorities. Although the odds are probably now against the Redstone line, the Court of Appeal might yet be persuaded to follow it.

77. Even if these priority arguments were to be upheld, however, caution needs to be taken as to whether something else may have occurred to undermine it. For example:

77.1 The seller/tenant may, explicitly or in effect, have had inquiry made of him before the transaction was entered into and have *"failed to disclose [the interest in question] when he could reasonably have been expected to do so"* (LRA 2002, Schedule 3, paragraph 2(b)). If that has happened, then the interest will not be an overriding interest under Schedule 3 paragraph 2.

This is particularly likely to have happened in pre-contract inquiries and answers to them (either directly to the mortgagee, or given in circumstances in which the mortgagee is entitled to rely on them), but that is not the only potential source on which a mortgagee might be entitled to rely.

Example: see UCB Bank plc v Beasley [1995] NPC 144 (CA) (unreported elsewhere)[20]

---

[20] This case concerned priority between a mortgage and an unpaid vendor's lien. The vendor in that case foolishly agreed to allow half of the purchase price to be paid into an unidentified offshore account. When this money failed to materialise, the vendor asserted that her unpaid vendor's lien was binding on the buyer's mortgagee. Without having to decide whether or not that would have been the result in other circumstances, the Court of Appeal decided that various of the questions and answers to inquiries raised by the buyer (subsequently passed on by the buyer's solicitors to the mortgagee's solicitors *"in accordance with the normal practice and at the bank's request"*), particularly that quoted below, prevented her from asserting her lien against the mortgagee under the equivalent provisions for overriding interests in the Land Registration Act 1925 (s.70(1)(g)):

77.2 Provisions in the contract of sale may affect priorities, either directly or indirectly.

77.3 There may be an estoppel against the seller/tenant, e.g. arising out of representations made in answers to pre-contract inquiries, or even arising from the contract itself.

77.4 A priority search certificate may still give priority to the beneficiaries of the search. The wording of LRA 2002 s.72 may not be easy to apply to a situation in which s.29(4) applies, but Judge Behrens also suggested in the NEPB case (*obiter*) that, if necessary, he would have held that a priority search certificate would give priority in that situation[21].

78. The alternative route, using the 'registration gap', applies only to tenancies at law which do not require registration under LRA 2002: essentially, tenancies for a term of 7 years or less[22]. The argument depends a quirk in the statutory provisions. The key elements in the argument go like this:

78.1 LRA 2002 s.23 sets out the "owner's powers". In relation to a freehold, these include the power to create a lease (under s.23(1)(a)).

78.2 A person may exercise the owner's powers if he is the registered proprietor: s.24(a). However, a person (such as a buyer) who has become entitled to be registered may also exercise the "owner's powers": LRA 2002 s.24(b)[23].

"4. Please supply full details of any rights or licences to which the property is subject or will be subject on completion or which otherwise affect the property (other than any disclosed above or in the draft contract or immediately apparent on inspection ...)

Answer: The seller is not aware of any.

6. Is the vendor aware of any other overriding interest (as set out in section 70(1) of the Land Registration Act 1925) to which the property is or will on completion be subject?

Answer: No."

In view of that conclusion, the court did not need to express any view on whether there would also have been an estoppel in favour of the mortgagee.

[21] See the NEPB case at [63]. The facts will not always justify this, however. For example, although such a certificate ought to be obtained by the buyer's or mortgagee's solicitor, that does not always happen. I have also seen application(s) to register being made outside the priority period given by such a certificate.

[22] LRA 2002 s.27(2)(b)(i).

[23] For the purpose and basic effect of this provision, see e.g. Ruoff & Roper, 'Registered Conveyancing', para.13.003.04, and Bank of Scotland plc v King [2007] EWHC 2747 (Ch) at [68].

78.3 If an owner creates an estate or interest which is not registrable (such as a tenancy for 7 years or less), then that has effect as if it involved a registrable disposition and were registered at the date of the grant: s.29(4).

78.4 Thus, a tenancy for 7 years or less, granted by the buyer, will take effect as if it had been a registered disposition immediately upon grant.

78.5 Taking those propositions together, a buyer of the freehold may grant a tenancy even if he is not registered at the time, and that tenancy will take effect as if it were a registered disposition at the moment of grant.

78.6 The date of grant of the tenancy in these cases will very often have been before the date on which the application is made to register the mortgage[24].

78.7 The default priority rule in LRA 2002 is in s.28: in effect, an earlier interest will prevail over a later interest. But this may be altered under s.29.

78.8 In particular, a s.29(4) disposition will have the effect (under s.29(1)) of postponing any interest affecting the freehold which is not "protected" at the time of grant.

78.9 If the mortgage was not registered at the date of grant of the tenancy, then it will not have been protected, within the meaning of s.29(2).

78.10 If that is right, then the tenancy takes priority over the mortgage[25], and it does not matter whether it would have been permitted under the terms of the mortgage[26].

---

[24] Registration is back-dated to the date of the application for registration: LRA 2002 s.74.

[25] The provisions of the Land Registration Act 1925 might also have led to the same outcome: compare Barclays Bank plc v Zaroovabli [1 997] Ch 321, in which a tenancy granted after a mortgage had been granted, but before an application had been made to register the mortgage, was held to have priority over the mortgage. Redstone went further, however, because in Zaroovabli the grantors were already registered when they granted the tenancy.

[26] See Zaroovabli. It may also be relevant that, under LRA 2002 s.26, the owner's powers are to be taken to be free from any limitation affecting the validity of a disposition, subject to the limitations in s.26(2), thereby preventing "*the title of a disponee being questioned*".

79. This argument was accepted in Redstone, but was rejected in the NEPB case (although on the basis of what appears from the judgment to be a relatively superficial analysis of the relevant provisions of the LRA 2002). It remains to be seen which line the Court of Appeal will take.

Other rights

80. Even if all else fails, there may still be yet other property rights which can be maintained against both the buyer and the mortgagee. These will depend on the particular circumstances of the case, but I can give one example from Redstone.

81. There, Mr Jackson was the sole registered owner of the property, but it was accepted by the mortgagee that Mrs Jackson had (as she asserted) a 50% beneficial interest in the property (subject to their existing mortgage). On the facts of this case, it was accepted that she was entitled to assert that interest (which was an overriding interest) against the mortgagee, thereby giving her a share in the value of the house. However, the situation is likely to be different in other circumstances, such as where there are joint owners, or where all equitable owners join in the sale.

The impact of FSA Regulation

82. Regulation under the Financial Services and Markets Act 2000 ("FSMA 2000") brings with it requirements for providers to be authorised for this type of business[27], protective requirements in relation to the making and operation of these schemes, and some limited minimum requirements. They are likely to apply to most situations in which a sale and rent back transaction takes place, although applicability would need to be checked[28].

83. For present purposes, I propose merely to summarise some of the more important features of those aspects of regulation which concern consumer protection and minimum standards. These all form part of the FSA Handbook: specially, that part known as MCOB (the part headed 'Mortgages and Home Finance: Conduct of Business'), as amended by the Sale and Rent Back

---

[27] Subject to limited exclusions, including that they are operating their scheme "by way of business".

[28] One particular requirement is that the transaction must give the seller, or a related person, an entitlement to occupy at least 40% of the land in question.

Instrument 2010. The applicable rules are fairly extensive and would need to be considered with the particular circumstances of each case in mind.

84. The minimum standards applicable to the 'rent back' are essentially as follows (see MCOB 2.6A.5B):

84.1 The tenancy must be for a term of at least five years, without any break rights for the landlord during that period, but with a right for the tenant to terminate on no more than three months' notice (and without any other conditions attached).

84.2 The tenancy must be on fair terms.

84.3 The tenancy must be an assured tenancy, but it may be a shorthold tenancy[29].

84.4 The tenancy must not make any provision for it to be brought to an end by the landlord other than on grounds for terminating an assured tenancy under the Housing Act 1988.

84.5 The tenancy must not make any provision for it to be brought to an end on any of grounds 2, 6, 8 or 9 in Schedule 2 to the Housing Act 1988.

85. Protective requirements include the following: (see, esp., but not exclusively, new MCOB sections 3.8B, 4.11, 5.9 and 6.9).

85.1 The product provider must give the seller specified disclosure and warnings related to the product. These include information relating to the specific terms and rights on offer, the price offered, fees payable, and the Market Value of the seller's property. They also include a FSA Consumer Factsheet (quoted above).

85.2 There are various restrictions and requirements relating to promotional methods and content.

85.3 There is a duty (MCOB 3.8B.8 R) *"not in any financial promotion ... [to] exploit the vulnerable nature or circumstances of any customer who may be in financial difficulties and at risk of losing his or her home and ... accordingly [to] avoid using in the promotion phrases or terms such as "fast sales", "rescue" or "cash quickly" or any other similar expression."*

---

[29] The original proposal by the FSA to exclude shorthold tenancies was dropped before the final rules were made.

85.4 There must be a valuation carried out by a valuer satisfying the competence and independence requirements, and who must owe a duty of care to the seller. The valuation must give the Market Value of the property, applying the RICS/internationally agreed definition of this.

85.5 The provider must have reasonable grounds to be satisfied of the affordability and appropriateness of the product for the customer, using specified categories of information, including an assessment of whether the benefits outweigh the disadvantages (including any impact on any entitlement to benefits) and the feasibility of the seller raising funds by alternative methods "*other than by a sale of his property*" (MCOB section 4.11).

85.6 There must be a written pre-offer documents, followed by a cooling offer period of 14 days, during which there is to be no contact with the seller; and action can be taken which may commit the seller to a specific agreement only once a written offer document has been signed and returned (MCOB 5.9.1 R(1)).

85.7 If the seller is in arrears under a regulated mortgage or home purchase plan, then there are requirements to notify existing lenders/plan providers of the proposal to enter into a sale and rent back as soon as a the pre-offer document has been provided (MCOB 6.9.8 R).

85.8 During the fixed term of the tenancy, the landlord may not rely on any ground for possession other than one permitted under MCOB 2.6A.5B R (2), and may only rely on a ground for possession if it is fair for the landlord to do so (MCOB 2.6A.5B R (3)).

86. Whether, and the extent to which, these requirements are being complied with in practice by all providers, and by those 'introducing' such products, is a moot point. A brief, personal trawl of the internet produced a mixed bag of different approaches, some more obviously concerned to honour the spirit of the requirements than others.

Additional remedies in relation to post-regulation transactions

87. There may also be additional routes for seeking redress if the sale and rent back transaction took place after these scheme became regulated. I do not propose to

try to set out all of the possibilities, or the issues which might need to be addressed, but further redress might include the following:

87.1 There may be a right to damages for breach of MCOB rules under FSMA 2000 s.150.

87.2 There may be a right to complain to the Financial Ombudsman Service, which could lead to various forms of award, including a financial award of up to £100,000 or directions to the respondent to the complaint to take specific steps. Such an award is enforceable through the courts.

87.3 The Financial Services Compensation Scheme may apply to a claim which the scheme provider cannot meet (financial limit: £50,000).

88. In addition, some transactions entered into in breach of certain prohibitions on the activities of unauthorised persons may be liable to be set aside, with restitution and compensation, under FSMA 2000 ss.26-28 and 30, although these provisions do not deal explicitly with third party interests.

89. The FSA (and the Secretary of State) also have various powers which might assist, such as the right to apply to the High Court for an order directing remedial action (FSMA 2000 s.380) or for a restitution order (s.382); and the FSA may be able to require an authorised person to make restitution (s.384).

Maitland Chambers
Lincoln's Inn

Andrew PD Walker
December 2010