

Existing tenant triumphs over subsequent mortgagee

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Introduction

The following discussion applies to land subject to the Land Titles Act (CAP 157) (“**LTA**”).

It is trite law that a lease is binding upon a mortgagee where the lease was granted prior to the creation of the mortgage. The mortgagee is usually made aware of the existing lease through its due diligence, prior to accepting a mortgage of a property as security. In the event of a default by the mortgagor and subject to one month’s notice to the mortgagor, the mortgagee becomes entitled to enter into possession of the property and to receive the rent payable by the tenant to the mortgagor. Thereafter, the mortgagee will have similar remedies as the mortgagor for obtaining possession of the property, should the term of the lease expire or the tenant fail to pay the rent. These rights of the mortgagee are set out in section 75 of the LTA.

However, in this unique case, the court examined whether the mortgagee can take vacant possession of the property in the event that the tenant has paid the full rent in advance to the mortgagor.

Facts

Mr Loh Boon Hua (the “**Mortgagor**”) had executed a mortgage (the “**Mortgage**”) over a property (the “**Property**”) in favour of United Overseas Bank Limited (the “**Bank**”) as security for certain loan facilities. At the point of granting the loan, the Mortgagor had informed the Bank that the property was being leased to Mdm Ding Yilian (the “**Tenant**”), pursuant to a tenancy agreement. The tenancy agreement provided for rent to be paid to the Mortgagor on a monthly basis for the entire duration of the lease.

The Mortgagor subsequently became bankrupt and defaulted on the loan repayments. The Bank then commenced an action against the Mortgagor for the delivery of vacant possession of the property to the Bank. The Bank accepted that the Mortgage was subject to the existing lease and was prepared not to insist on immediate vacant possession of the property if it received the monthly rent payments from the Tenant.

Pursuant to the proceedings, it was found that the Tenant had already paid the full sum of rent payable for the remaining duration of the lease to the Mortgagor in advance. This was done without the knowledge or approval of the Bank. The Tenant’s position was that she should be entitled to possession of the property until the expiry of the lease, unless she was given a refund of the paid-up rent for the remaining term of the lease.

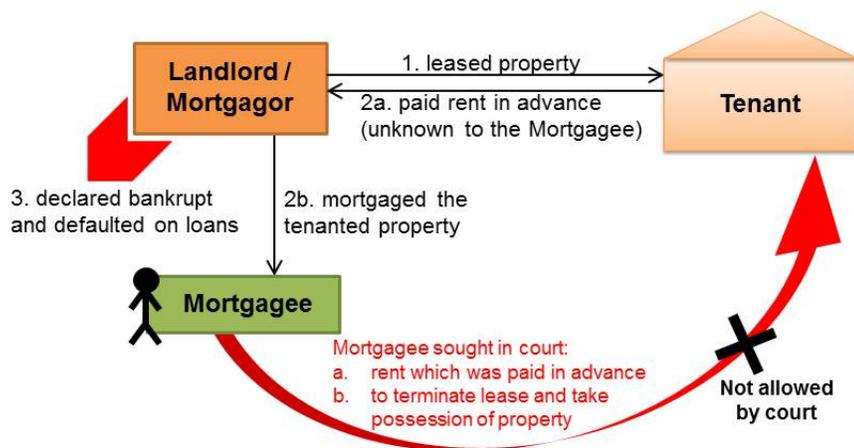
Essentially, the Bank’s argument was as follows:-

1. The Mortgage should be subject strictly to the exact terms of the tenancy agreement, which provided for rent to be

paid by the Tenant monthly. The Tenant, having undertaken the risk of making rent payments in advance, could not now request a refund.

2. As the mortgagee, the Bank was entitled to receive rent payments in accordance with the terms of the tenancy agreement, regardless of any issue of refund of rent which was a matter between the Mortgagor and the Tenant. In this regard, the Tenant's refusal to make further payments of rent in respect of the lease was grounds for the Bank's right to terminate the lease between the Mortgagor and the Tenant.

This diagram sums up the facts stated above.



Judgment

Notwithstanding the Bank's arguments, the court found that the Bank was entitled to vacant possession of the property only upon the expiry of the lease.

In its analysis, the court reasoned that there was no valid ground for termination of the Tenant's lease. The Bank's entitlement to demand rent from the Tenant arises from its position as (i) a receiver appointed by the mortgagee, under the mortgage, and (ii) a mortgagee who has given notice of his intention to receive rent in its own right. In the first case, since a receiver would be deemed to be an agent of the mortgagor, it follows that the receiver cannot demand any further rent if rent had previously been paid in full to the mortgagee. In the second case, the court found that rent represented an item on a notional "balance sheet" between the mortgagor and mortgagee. While collection of rent could be applied in satisfaction of the outstanding debt, it was simply an item to be taken into account when the security over the mortgage is exercised for full and final settlement. However, this did not form valid grounds for termination of the lease as against the Tenant.

Significantly, the court was convinced that a tenant should not be made to suffer the peril of paying rent twice, especially since rent had been paid in advance and in full to the mortgagor. This is even if the advance payment was made against the terms of the tenancy agreement.

For these reasons, the court ordered, inter alia, that the Bank was entitled to vacant possession of the property only upon the expiry of the Tenant's lease.

Conclusion

This case reaffirms the strength of a prior lessee's interest as against a subsequent mortgagee. In light of this case, some possible measures that mortgagees can adopt to minimise their risk and protect their right to receive the rent payments would include:-

1. Taking an assignment of rental proceeds in conjunction with the mortgage.
2. Ensuring that the mortgagor undertakes not to receive rent payments in any manner other than set out in the tenancy agreement and/or to notify the mortgagee if it receives rent payments in advance.

Mortgagees should be aware of the implications an existing lease may have on their rights as a mortgagee, particularly the risk of rent being paid in advance to the mortgagor. The power of sale only materialises, and the mortgagee may only realise its security to satisfy the outstanding debt, after the lease term (for which rental has been paid for in advance) has expired.

Your Key Contacts



Doreen Sim

Senior Partner, Singapore

D +65 6885 3697

doreen.sim@dentons.com