



PRACTICE GUIDE FOR SECOND MORTGAGES

# DEEDS OF PRIORITY



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**To have a deed of priority or not to have a deed of priority, that is the question.**

Our experience is that often lenders do not know when a deed of priority is required. Most lenders assume that a deed of priority will be required by a first mortgagee or that they should require one if acting as first mortgagee, but as we have seen in our last publication, there are a number of jurisdictions in which a first mortgagee cannot force a second mortgagee to enter into a deed of priority.

Secondly, we find that a number of lenders, and sometimes legal practitioners, do not appreciate what a deed of priority can do, and this often results in a document that does nothing more than re-state the position at law.

In both these situations, the borrower is often paying the cost of a step which is unnecessary or worthless. In order to maximise their value proposition for customers and correctly price their loans, lenders should understand when a deed of priority should be used and how it should be used to provide value to their security and maximise the exercise of two mortgagees engaging with one another.

This is the third of our publications in the Practice Guide for Second Mortgages series. In this series we are answering some frequently asked questions regarding second mortgages. This publication and our overall guide is designed to give lenders a more in-depth knowledge of second mortgages and some tips and traps to watch out for.

Some of the comments in this publication also apply to first mortgage and of course apply to third and other subsequent securities for lenders with that risk appetite.

**DISCLAIMER:** *The advice in this publication is general in nature and should be viewed in light of your specific circumstances and transaction requirements. We encourage you to contact us to discuss your needs.*

# WHEN IS A DEED OF PRIORITY REQUIRED?

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**A deed of priority (DOP) is usually entered into as a function of obtaining the first mortgagee's consent. However, let's review when the first mortgagee's consent is required:**

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|                              |          |   |
|------------------------------|----------|---|
| Queensland                   | NO       | The first mortgagee cannot object to a second mortgage or treat it as a default. A DOP is only advisable if it assists the second mortgagee.  |
| Northern Territory           | NO       | The first mortgagee cannot object to a second mortgage or treat it as a default. A DOP is only advisable if it assists the second mortgagee.  |
| South Australia              | OPTIONAL | The first mortgagee cannot refuse a second mortgage but may treat it as a default. A first mortgagee could offer a DOP or you may ask for a DOP in order to avoid threat of default on the first mortgage security. |
| Western Australia            | OPTIONAL | The first mortgagee cannot refuse a second mortgage but may treat it as a default. A first mortgagee could offer a DOP or you may ask for a DOP in order to avoid threat of default on the first mortgage security. |
| Tasmania                     | OPTIONAL | The first mortgagee cannot refuse a second mortgage but may treat it as a default. A first mortgagee could offer a DOP or you may ask for a DOP in order to avoid threat of default on the first mortgage security. |
| Australian Capital Territory | OPTIONAL | The first mortgagee cannot refuse a second mortgage but may treat it as a default. A first mortgagee could offer a DOP or you may ask for a DOP in order to avoid threat of default on the first mortgage security. |
| Victoria                     | OPTIONAL | The first mortgagee cannot refuse a second mortgage but may treat it as a default. A first mortgagee could offer a DOP or you may ask for a DOP in order to avoid threat of default on the first mortgage security. |
| New South Wales              | YES      | You cannot register a second mortgage without the first mortgagee's consent and the first mortgagee will usually require a DOP as a condition of consent.   |

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# WHY ENTER INTO A DEED OF PRIORITY?

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Whether a deed of priority is signed as a function of obtaining the first mortgagee's consent or for other reasons, the purpose of a deed of priority is to:

- agree on rights additional to the base law;
- limit priority; and / or
- agree on notice requirements and relational aspects between the mortgagees.

## ADDITIONAL RIGHTS TO THE BASE LAW

To correctly draft a deed of priority and understand what it should cover, it is important to understand what rights are already afforded to mortgagees under the base law of the relevant jurisdiction.

We all know and appreciate the basic law of priorities, being that mortgages have the priority in which they appear on title, but there are at least two other very important rights to consider.

### TACKING

Tacking is the provision of further advances to a mortgagor beyond what was agreed, increasing the amount secured by the mortgage. That is the 'tacking on' of additional liability.

The House of Lords in 1861 concluded that tacking by a mortgagee is not permitted once the mortgagee has received notice of the registration of a subsequent mortgage. Any further advances made after receiving notice of a second mortgage will take after the second mortgage is satisfied unless those advances were provided for in the facility agreement, for example a construction loan that provides for payments up to a facility limit.

This judgement was challenged in a later case in 1899 which decided that tacking cannot be made even when the facility obliges the mortgagee to make further advances. Later cases considered both decisions and found in various ways including by providing for certain exclusions to the rule, such as where the making of the further advance is to provide for works that will increase the value to the property to cover the additional liability.



# WHY ENTER INTO A DEED OF PRIORITY?

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In QLD and NT, the original rule of the House of Lords is codified in legislation. That is, each of the QLD and NT acts of parliament say that provided the second mortgagee has given notice of its mortgage to the first mortgagee, the first mortgagee cannot include in its priority any later or subsequent advances unless expressly provided for in the facility document. Importantly, this must be actual notice in writing by the second mortgagee. The fact that the second mortgage appears on the titles register is not sufficient notice.

In every other jurisdiction, the rule against tacking is not codified in legislation. The courts have applied the common rule at times but, as there are exceptions and case law can turn on its facts, lenders may wish to expressly address tacking in a deed of priority. This is usually achieved in the section of the deed of priority listing the priorities and their respective priority limit.

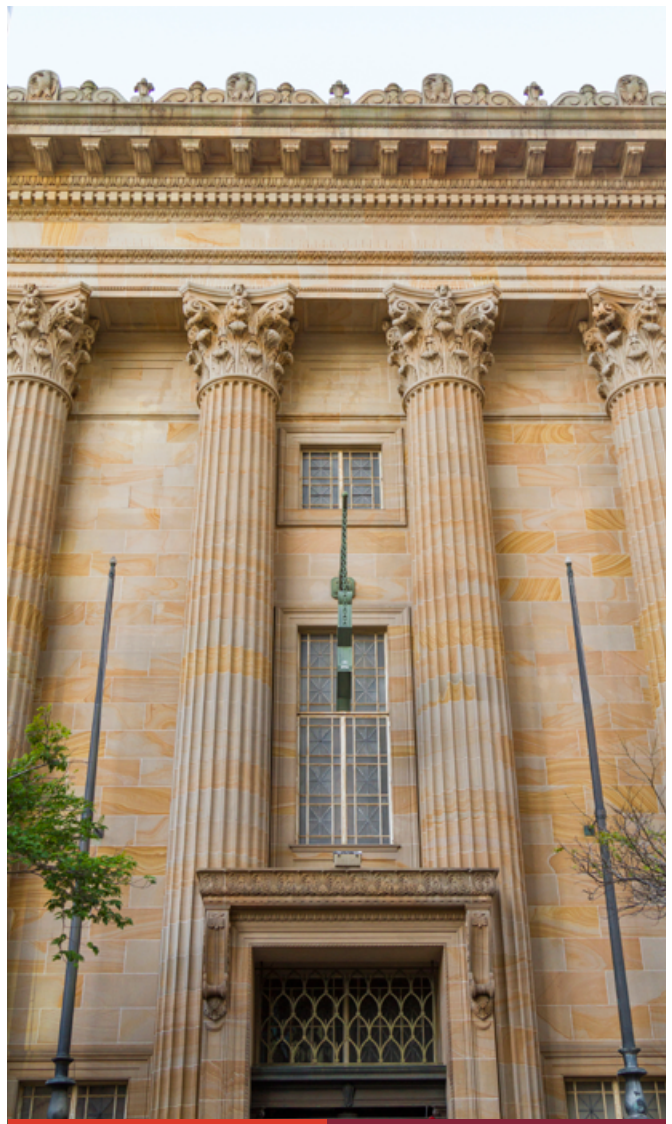
## TAKE OUT

A take-out right is an industry term referring to the right of a subsequent mortgagee to payout (ie. take-out) an earlier mortgagee.

This right is codified as a right to obtain a transfer of the earlier mortgage in QLD and NT. In these jurisdictions the legislation states that, upon payment of the payout figure of an earlier mortgage by a later mortgagee, the earlier mortgagee must transfer to the later mortgagee all of its rights under the first mortgage.

In the remaining jurisdictions, there is no express right of transfer of this kind. Rather the borrower is usually entitled to redeem the mortgage at any time and consequently refinance could be arranged via the borrower. However, a take-out right is relevant where the borrower is unco-operative or where there are other mortgagees on title, because the nature of a take-out right is usually such that others involvement is not required.

As each jurisdiction has specific requirements regarding transfer and redemption rights, it is valuable to add a specific take-out provision in the deed of priority by which the mortgagees agree on the specifics of how the take-out right will operate. That said, it is fundamental that the lawyer understands the base law in the relevant jurisdiction to consider what the take-out provision should say, and take great care in its drafting as we have come across at least one situation where a second mortgagee exercising a take-out right without obtaining evidence of payout found themselves in an irrevocable agreement to take out for a higher amount than expected.



# WHY ENTER INTO A DEED OF PRIORITY?

## LIMITING PRIORITY

We have touched on one of the essential features of a deed of priority and that is to state quite conclusively the priority limit of each mortgage, which confirms the amount available on each facility, and has the effect of postponing in priority any tacking or collateral liabilities that is above that limit.

Normally, the priority limit is expressed as an amount plus any additional interest and legal or execution costs that may arise. Rarely a mortgage will be capped in full, though this is possible if that is the requirement of the transacting parties.

When expressing the priority limit under the standard methodology of an amount plus interest and costs, it is important to take into account:

- available re-draws;
- further advances provided for in the document;
- capitalised interest; and
- establishment fees and charges part of the initial advance;

all of which may require the adoption of an amount that is not necessarily the principal of the facility or the current balance of the facility, depending on how the facility agreement and the deed of priority are drafted.

## NOTICES AND RELATIONAL ASPECTS

Each jurisdiction requires a first mortgagee to account to second mortgagees for any excess proceeds when effecting power of sale. Beyond this, different jurisdictions have different provisions in terms of when notices are required and other rights governing the relationship between the parties, including take-out, as we have just discussed.

It would be a missed opportunity when negotiating a deed of priority not to agree in writing on some important aspects of the ongoing relationship between the mortgagees that are likely to be of value to both mortgagees. This includes:

- when a mortgagee should give notice to the other, the obvious time being if default has occurred but also if a mortgagee takes possession or enters into a contract of sale;
- the requirement for a mortgagee to deliver a discharge of their mortgage at settlement if sale is effected by the borrower, such that take-out or execution steps are not required;
- restrictions regarding execution rights when a mortgagee has already commenced execution under their mortgage;
- information rights and confidentiality obligations between mortgagees; and
- establishing the priority or mirroring the priority terms in respect of security interests registered by the mortgagees on the Personal Property Securities Register.



Whilst deeds of priority need not include the borrower as a party, it is possible to add the borrower as a party in order to gain consent to material agreements between the parties that may affect the borrower's rights such as the delivery of information to another mortgagee or the delivery of a discharge at settlement when only a transfer would be called for.

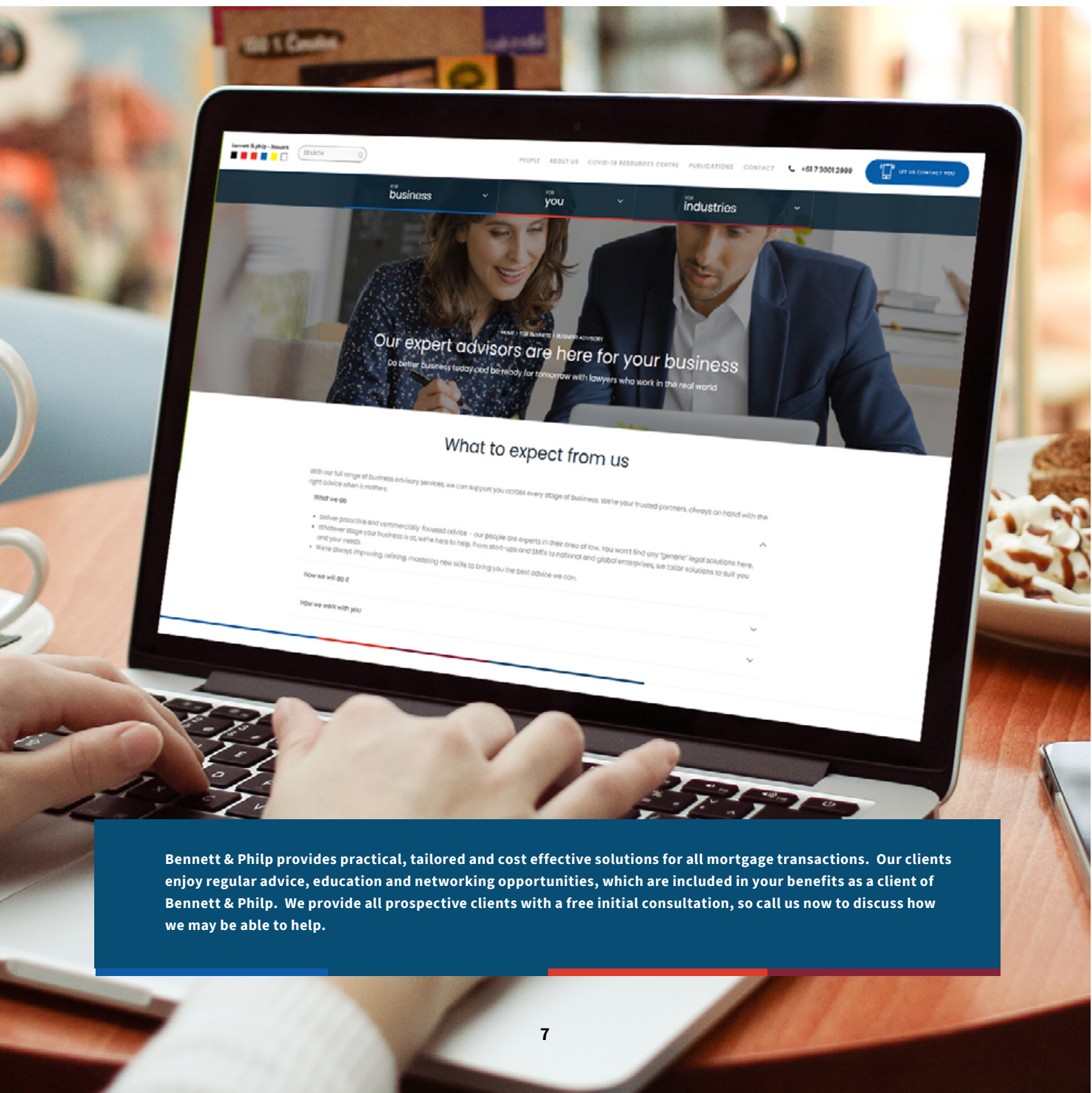


# CONCLUSION

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**We hope that this publication has assisted you in understanding when a deed of priority is required or advisable, and how it can be a useful tool in the relationship between mortgagees. We hope we have given you some things to think about in terms of your current procedures and documentation.**

If you have any questions regarding this publication or wish to discuss your policies and procedures with us, please don't hesitate to contact us.



**Bennett & Philp provides practical, tailored and cost effective solutions for all mortgage transactions. Our clients enjoy regular advice, education and networking opportunities, which are included in your benefits as a client of Bennett & Philp. We provide all prospective clients with a free initial consultation, so call us now to discuss how we may be able to help.**

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