

The end of encumbrances in property developments?

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As most people involved in property development will know, encumbrances are commonly used to register what amount to personal covenants on the title to a property. Encumbrances were the only method by which obligations of the owner of land to third parties who did not own adjacent land could be recorded against the title.

Common examples include:

- Requiring owners to join residents associations
- Requiring owners to contribute to the upkeep of commonly owned infrastructure or leisure assets
- Requiring owners to comply with the provisions of other documents such as development agreements.

In its report on the new Land Transfer Act, the Law Commission noted that the use of encumbrances for these collateral purposes is not what encumbrances were designed for in the Land Transfer Act 1952. As many people are aware, encumbrances are mortgages for the purposes of the Land Transfer Act 1952 and the Property Law Act 2007. They were designed to secure rent charges or the payment of annuities.

Also, the fact that an encumbrance operates as a mortgage creates potential issues with funders as mortgages securing property finance are registered behind the first ranking encumbrance. Funders and the development community have well settled methods of dealing with these issues but it would be preferable if collateral covenants could be dealt with in a different form of documentation.

The new Land Transfer Act 2017 contains that very solution.

The Land Transfer Act 2017 is scheduled to come into force in November 2018.

It amends the Property Law Act 2007 by permitting land covenants in gross. Currently, a land covenant in gross may only be created under section 108 of the Resource Management Act to give effect to a condition of a resource consent. Otherwise, a land covenant requires a dominant tenement as well as a servient tenement. That is, there must be land that gets the benefit of the covenant. The new sections use the traditional covenant language so the owner is referred to as the covenantor and the person having the benefit of the covenant in gross is referred to as the covenantee.

The new sections (307A to 307F and 318A to 318E in the Property Law Act 2007) provide that:

- A covenant in gross is enforceable by the person having the benefit of the covenant and persons claiming through that person
- A covenant in gross binds the covenantor, the covenantor's successors in title and persons claiming through the covenantor or the covenantor's successors in title. Successors in title include an occupier for that time being of the land that has the burden of the covenant
- A covenant in gross is binding in equity on every person who becomes the owner of the burdened land and every person for the time being the occupier of the burdened land
- A covenant in gross may be registered against the title to the burdened land. This is not automatic so people will have to ensure that this is an agreed outcome in any contracts creating covenants in gross. When registered, the title is subject to the covenantee's interest under the covenant. The covenant will have priority over instruments registered after it
- A covenant in gross may be modified or extinguished if there has been a change since its creation in all or any of the following:
 - the nature or extent of the use being made of the burdened land
 - the character of the neighbourhood
 - any other circumstances the Court thinks relevant.

The ability from November 2018 to register covenants in gross should do away with the need to use encumbrances in many circumstances.

In our view, the covenant in gross is a better device as the covenants will clearly bind the covenantor's successors in title.

Because they are not a species of mortgage, the covenantee's consent will not be required to dealings with the land.

We recommend that financiers requested to consent or grant first priority to an encumbrance after November 2018 should consider whether a covenant in gross might not be preferable.

As land covenants will bind persons claiming through a covenantee or their successor in title, subsequent mortgagees will be bound by prior registered land covenants.

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