

September 2013

LAND LEASES AND THE PPS ACT

1. Introduction

Practitioners for both landlords and tenants need to understand that the *Personal Property Securities Act 2009* (Cth) (PPS Act) may apply to the lease of premises because:

- Sometimes a landlord of premises also leases goods to the tenant.
- A landlord may obtain a cash security deposit from the tenant.
- A landlord may provide a lease incentive to pay for the tenant's fitout.
- When a tenant vacates premises, goods may be abandoned.

The LPLC recommends that practitioners consider the following matters when acting in relation to a lease of premises.

2. Personal Property

Under the PPS Act where a landlord leases goods to a tenant, this gives rise to a PPS Lease. 'PPS Lease' is defined pursuant to the PPS Act and includes a lease of goods for a term exceeding one year. Examples include leasing of non-fixed fitout items, furniture and/or equipment by a landlord to a tenant.

2.1 Security deposit

It is usual for a tenant to provide some form of security deposit. Clause 13 of the 2012 version of the LIV Lease of Real Estate gives the tenant the right to provide cash or a bank guarantee in payment of the security deposit.

For the purposes of the PPS Act **only a lease security deposit in cash creates a security interest and the landlord becomes a secured party.**

A bank guarantee and/or a personal guarantee given in support of a lease do not create a security interest.

Beware!

A charging clause in a lease and/or guarantee where the tenant or guarantor charges assets as security for obligations pursuant to the lease/guarantee creates a security interest.

2.2 Lease incentive

Sometimes a landlord will provide a lease incentive. The incentive may be used to pay for the tenant's fitout and the lease may include a clause that the landlord retains ownership of the fitout until the end of the lease.

This arrangement gives rise to a security interest and the practitioners acting for the landlord, tenant or tenant's financier need to consider and advise their respective clients on the PPS Act and the possible registration of the security interest by the landlord.

Importantly, the landlord needs to understand that the risk in failing to register the security interest is that a person with a registered security interest over the tenant's goods may have a superior interest in relation to this fitout. In other words, **because the tenant has possession of the fitout, the tenant may grant a security interest over the fitout to a third party which may defeat the landlord's interest.**

2.3 Abandoned goods

A clause which allows a landlord to sell any property left behind by the tenant at the end of the lease and use the proceeds to either reduce the tenant's debt or use the proceeds in satisfaction of the obligation creates a security interest.

By comparison, a clause in a lease to the effect that the landlord may treat as the landlord's own, any property the tenant leaves behind at the premises when the lease ends or is ended does not create a security interest.

2.4 Practitioners should be aware that:

- The PPS Act does not apply to the lease of a furnished residential property. See exclusion of 'consumer property' in s.13(2)(c).
- The PPS Act does not apply to land. Refer to the definition of 'personal property' in s.10 and s.8(1)(f)(i).
- The PPS Act does not apply to fixtures. See s.8(1)(j).
- Pursuant to s.46 of the PPS Act a lessee takes personal property free of any security interest where the personal property is provided in the ordinary course of the lessor's business.

There is some argument that where, for example, the landlord leases out multiple tenancies and these leases also include a lease of personal property such as desks, dishwashers and fridges, the lessee is entitled to rely on s.46 of the PPS Act.

3. Acting for the landlord

3.1 Search the Personal Property Securities Register

A landlord may wish to know whether there are any security interests registered over:

- The incoming tenant, as part of a due diligence in relation to the tenant's solvency.

- The landlord's own goods which are to be leased to the tenant. The financier of a previous tenant may have registered a security interest over the landlord's goods. The landlord will want a release from any financier of a former tenant before granting a lease over the goods to the new tenant.
- Any personal property which the tenant brings onto the premises, and which are abandoned by the tenant at the end of the lease term.

The landlord's practitioner should search the register to find any security interests registered in the name of the landlord and tenant. To do that the practitioner will need to know certain information, such as:

- (a) name and date of birth of any individual grantor;
- (b) name of any organisational grantor;
- (c) ACN for any organisational grantor;
- (d) ABN for any organisational grantor that has an ABN;
- (e) ARBN for any organisational grantor that has an ARBN; and
- (f) ARSN for any organisational grantor that is the responsible entity of a registered scheme, if the scheme has an ARSN.

Specific security interests can also be searched if the landlord has the registration number ie the number allocated to the financing statement upon registration on the PPS Register.

Beware!

Sometimes searching the PPS Register alone is not enough to find all security interests.

In some circumstances it is not necessary to register a security interests on the PPS Register: for example where the secured party has perfected the security interest by possession. See s.21 and s.24 of the PPS Act.

Control of the personal property is, in some circumstances, effective to perfect a security interest. See s.21, s.25 - 29 of the PPS Act.

Practitioners should also refer to the factsheet "Searching the PPS Register - Considerations regarding migrated registrations" available from the "Factsheets" page under the "Ask the Registrar" tab at www.ppsr.gov.au. In this Fact Sheet you will find some tips on how to search for a grantor. For example, this Fact Sheet explains that, the form in which the name of an individual appears on the PPS Register, will depend on which register it was migrated from. As a result it may be necessary to search by one or more family names or a first name, the initial of the second given name and the family name.

The practitioner should give details to the landlord client of any registered security interests and also ask the client whether or not they are aware of any unregistered 'encumbrances' so that these can be dealt with in the lease, as necessary.

3.2 Release of security interests

The tenant will clearly want the following security interests released:

- Before the lease commences, any security interests registered over the landlord's goods to be leased to the tenant.

Sometimes a landlord's financier may have a security interest registered over the landlord's goods to be leased to the tenant. Rather than providing a release, the secured party would usually give consent to the lease.

- At the end of the lease term, any security interests registered against the tenant's name for:
 - (a) The landlord's goods leased to the tenant.
 - (b) The cash security deposit paid to the landlord.
 - (c) Any fitout to be removed by the tenant that was funded by a landlord incentive.

At the end of the lease term, the landlord will also clearly want a release of any security interests registered over the landlord's goods leased to the tenant by any tenant's financier.

In most cases, the practitioner will be instructed to obtain any necessary releases. If the client elects to arrange the release of any security interests, then clear written advice should be given to the client as to what is required and when and the consequences of failing to do this. The same applies to any consent to the lease by a landlord's financier.

The landlord and tenant may also want any registered security interests, not only released but also removed from the register by having the secured party lodge a financing change statement.

Some security interest registrations will relate to just the assets in question and it will be relatively simple to have that security interest removed where the secured party registers a financing change statement that states the security interest is discharged.

Where the personal property is part of the collateral in an all present and after acquired property security interest (an ALLPAAP) then a financing change statement can also be lodged removing the specific property from the registration.

However, where the personal property makes up just part of a class of goods included in a financing statement it can be more problematic. Individual goods cannot be removed from a 'non ALLPAAP' financing statement without lodging a new financing statement with the particular goods omitted. Lodging a new financing statement would result in a loss of priority for the security holder.

In some instances, the form of release will contain an undertaking that the secured party will lodge a financing change statement within a certain time after the release is provided, usually 10 business days. In other instances a financing change statement will be lodged prior to the lease commencing which will remove the need to obtain a release.

3.3 Form of release

Practitioners should carefully consider the wording of the form of release.

The Australian Banker's Association has issued a form for use by banks when releasing a security interest. This form is available at:

<http://www.bankers.asn.au/Submissions/Personal-Property-Securities/Personal-Property-Securities>

Beware!

- Some banks are not using this form of release.
- Some banks are using a modified version of this form.
- Non-banks will probably have their own form of release.
- A financing change statement cannot be registered in certain circumstances, for example for a 'non' ALLPAAP security where only some collateral is released.
- The ABA release is issued in favor of the grantor/vendor i.e. not the purchaser.
- Some releases provide that the security holder will lodge the financing change statement within 10 business days after providing the release.

3.4 Registering security interests

When acting for the landlord, practitioners should seek instructions as to **whether or not the landlord wishes to register any security interests**.

For goods leased to the tenant, the security deposit and any lease incentive, it would be prudent to register the security interest when the lease is entered into.

Registration should also be considered where the lease allows a landlord to sell any property left behind by the tenant at the end of the lease and use the proceeds to either reduce the tenant's debt or use the proceeds in satisfaction of the obligation creates a security interest.

In any event, where a tenant vacates and goods are abandoned, **before the landlord seeks to deal with the goods, the practitioner should advise the landlord that it is necessary to search the PPS Register** to see if anyone has a registered security interest in relation to the goods, as this interest may prevent the landlord from dealing with the goods as the security provider may have a superior interest.

The landlord would, in those circumstances need to contact the secured party to make the necessary arrangements for dealing with the goods, which may include removal of the goods by the secured party.

Further information about registering a security interest can be found in the LPLC Bulletin "PPSA Bulletin No. 2 – *Personal Property Securities Act 2009 (Cth) Practicalities*".

4. Lease document

The November 2012 version of the LIV Lease of Real Estate does not contain any express reference to the PPS Act. In August 2013, the LIV issued a PPS Act clause for inclusion in the LIV Lease. To obtain a copy go to:

<http://www.liv.asn.au/PDF/ENews/20130730-LIV-Commercial-Lease-Additional-Provision>

The definition of 'premises' in the LIV lease includes the 'landlord's installations' which may include personal property owned by the landlord. This means the landlord is leasing both the premises and landlord's installations to the tenant, which may include a lease of personal property.

Examples of installations which may be personal property are free standing fans or free standing air conditioning units. In the matter of *Cancer Care Institute of Australia Pty Limited (administrator appointed)* [2013] NSWSC 37, two Clinac iX linear accelerators (which are used for radiation treatment) were treated as 'goods' for the purposes of the PPS Act. There is a good discussion in this case of what the test is for determining whether an item is a good or fixture.

The following should be considered in any lease:

- A condition to require any or which security interests to be released. For example, a release of a security interest over a cash security deposit would usually be provided once the lease term ends. It may not be appropriate in some circumstances for a landlord to release a security interest at the end of the lease. For example, if the tenant has not fulfilled its make good obligation, the landlord may wish to continue to hold the security deposit and retain any PPS Act registration in relation to the security deposit.
- Include any relevant serial numbers, VIN, PPS Register registration numbers in the lease for the avoidance of any doubt especially in relation to describing the releases which must be provided.
- Where a full release is to be provided, a condition in the lease that any relevant secured party will register the necessary financing change statement within a reasonable specified period of the release being provided.
- An acknowledgment should be given by the grantor that a security interest is being granted. For example, the tenant would acknowledge that the landlord is granted a security interest over any cash security deposit or abandoned goods.
- An obligation imposed on the tenant/grantor to do all things necessary to enable the perfection of a security interest.
- Where assets include goods and fixtures, prescribe in the lease which items are goods and which items are fixtures. This will avoid a dispute as to what items require a release because the PPS Act does not apply to 'fixtures' so no release is required.
- A clause that allows the landlord to remove the tenant's right to receive notices pursuant to section 157(1) of the PPS Act. The tenant however may wish to retain this right.

5. Acting for the tenant

5.1 Advice prior to signing the lease

Where a tenant's practitioner has been given the opportunity to see the lease before it has been signed the following should be considered in relation to the PPS Act.

Discuss with the client if there is any personal property included in the lease. See the discussion about what might be personal property in a leasing arrangement in the “Personal property” section of this bulletin.

Consider whether the lease contains the conditions discussed in the “Lease document” section of this bulletin. Negotiations should be entered into in relation to those issues if the lease is silent.

A search of the PPS Register should be made to determine if there is any security interests registered over the personal property included in the lease. For example, the landlord, the landlord’s financier or a financier of a previous tenant may have registered a security interest over goods leased by the landlord to the previous tenant.

Searching the register using the landlord’s details will reveal if the landlord’s financier has a security interest in the goods to be leased. While it is unlikely that this security interest will be released, it does give the tenant the name of the financier for the purpose of obtaining consent to the lease.

See the “Release of security interests” section of this bulletin for the information required to search a landlord or previous tenant. A lease should not be entered without this information if the lease includes personal property.

Where there are any security interests, the practitioner should discuss with the tenant the need to obtain a release of any security interest and/or obtaining the consent from a landlord’s financier.

5.2 Advice where the client has already signed the lease

Where a tenant’s practitioner has not been given the opportunity to review the lease before the tenant signed, the following should be considered in relation to the PPS Act.

- Discuss with the client if there is any personal property included in the lease. See the discussion about what might be personal property in a leasing arrangement in the “Personal property” section of this bulletin.
- If personal property is included in the lease, consider the issues raised in the “Lease document” section of this bulletin.
- Where a security interest over personal property included in the lease, has been registered by the landlord over the tenant, check the lease to determine whether or not the landlord had a right to register the security interest.
- Where the landlord had a right to register a security interest over the tenant, explain to the tenant the need to obtain a release and the appropriate time for obtaining this release. For example, a release may be required at the end of the lease where the landlord has registered a security interest over a cash security deposit provided by a tenant where the cash security deposit is being refunded to the tenant.

5.3 Advising on finance documents

If a practitioner acting for the tenant is asked to advise on the tenant’s finance documents he/she should carefully consider any clauses in in relation to the PPS Act.



Common provisions include:

- Requiring the client to “do anything” the bank requires in connection with the PPSA. This seems very broad and the possible impact of this should be highlighted to the client
- Contracting out of any notices that the financier is able to under the PPS Act, for example, the right of the client to receive notice of registrations on the PPS Register. (see s.157 of the PPS Act).
- Contracting out of providing any information requested by interested parties under s.275 of the PPS Act.
- Stating that the tenant will be in default if there is a registration of any new security interest. This may be a problem because there could be many further security interests created by the tenant in the running of the business, for example, a ‘retention of title’ clause in any supply agreement will create a security interest which can be registered on the PPS Register.

6. The retainer

Practitioners should carefully consider what matters need to be included in their retainer letter in relation to the PPS Act. One example is to specify who is responsible for registering the financing statement for a cash security deposit.

Legal Practitioners’ Liability Committee

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