**Growing Places Fund**

**Loan Security Options**

**15th October 2021**

# The Growing Places Fund panel have to date utilised Parent Company Guarantee as a security option against loans issued, on the advice of legal representation for the Accountable Body - this being a much quicker and therefore cheaper (as in the cost of legal fees) method of security than, for example, issuing a legal mortgage (charge against a capital asset).

1. Following experience gained from London House, and the default position of their repayment, it became apparent that the Parent Company Guarantee did not offer adequate means to enforce repayment of the loan, as the company simply declared their inability to repay the loan either from the applicant organisation or the parent company contracted as guarantor. The panel are therefore minded to take this into account when issuing loans going forward.
2. Reference should be made to a memo of 08.05.2012 from the Director of Law and Democracy to Sophie McFie Hyland (Appendix A). Whilst the conclusion drawn from this memo with regard to the preferred security option is that this should be in the form of a bond, the advice from legal representation for the Accountable Body is that a bond will likely be cost prohibitive and therefore **a legal mortgage (charge) should be adopted as the preferred method of security** in the first instance.It is acknowledged that there may be circumstances where the Council as Accountable Body are happy to adopt a Parent Company Guarantee albeit not as the default position and on a case-by-case basis.
3. **For all projects going forward to contracting of a Growing Places Fund loan from the date of this document, the Growing Places Fund panel recommends that the security option highlighted in paragraph 3 above should be adopted as a priority for all successful project awards under this loan fund. The GPF Panel would therefore request approval of this revised policy from the LEP Executive Board.**

Appendix A

STAFFORDSHIRE COUNTY COUNCIL MEMORANDUM

To:

From: **Director of Law and Democracy**

My Ref: SMH/Zip001134 Your Ref:

(Sophie Mcfie-Hyland – Ext. No. 276297) Date: 08 May 2012

# **Local Enterprise Partnership Growing Places Fund – Financial issues**

**Introduction**

In the Stage 2 application forms for the Growing Places Fund the applicants were asked what security they could provide for the loans. The security options are as follows:

* Bond;
* Parent company guarantee;
* Lien;
* Pledge;
* Charge; and
* Mortgage.

Blackburn House and Beacons Business Park Projects have offered parent company guarantees which do not appear to be sufficient

**Security options**

**Guarantee or Bond**

The guarantor’s obligation under the guarantee or bond will depend on whether the document operates as a “guarantee” or as an “on demand” payment obligation. On demand bonds (like an indemnity) impose a primary obligation on the issuer to pay in the circumstances where one party fails to perform the contract

The traditional form of bond operates as a guarantee: the guarantor promises to be directly answerable for the payment of a debt owed by one person to another or the fulfilment of a person’s contractual obligation owed to another in the event of the debtor (or principal’s) default. Its basic function is to provide security for performance, particularly where the debtor becomes insolvent.

On demand bonds (like an indemnity) impose a primary obligation on the issuer to pay in the circumstances where one party (the principal or seller) fails to perform the contract, without the other party (the beneficiary or buyer) having to sue the defaulting party and prove breach of contract. In contrast, the obligation to make payment under a guarantee is dependent on the buyer establishing a liability on the part of the seller in respect of the underlying contract.

The effect and commercial purpose of an on demand bond is quite different to a guarantee. On demand bonds impose a primary contractual obligation on the issuer to pay a specified sum, of money on the happening of a specified event or events. The bond is normally expressed to be payable “on demand” or “on your first demand” and the buyer is entitled to payment under an on demand bond simply on submitting a statement that the applicant is in default of the contract and a loss has been suffered.

As a local authority the risk to the applicant and the bank to the bond being unfairly called is minimal or non-existent.

Despite the very different nature of a guarantee and an on demand payment obligation, the terms “performance guarantee” and “performance bond” have been applied to both and often interchangeably. Confusingly instruments issued by insurance and surety companies are commonly referred to as bonds, but are usually guarantees, and instruments issued by banks, commonly referred to as guarantees, are often on demand bonds.

**Lien**

There are three main types of lien that may arise:

* Common law lien (also known as a legal lien);
* Equitable lien; and
* Statutory lien.

In addition, a fourth type of lien is often referred to: a contractual lien. Rather than creating a lien, a contractual lien normally extends, by way of contract between the parties, a common law lien by providing for enforcement rights (such as a power of sale over the goods) if there is a default. However, a contract could also be used to create a lien in favour of a creditor who would not otherwise be entitled to a lien under a general law. A contractual lien is more akin to a pledge. The distinction between a contractual lien and a pledge is that, unlike a pledge, the creditor under a contractual lien has possession of the goods for a purpose other than that of the taking of security.

A common law lien (also known as a legal lien) is a creditor’s right to retain possession of a debtor’s property until the debt has been repaid. This is merely a passive right to retain the property and gives the creditor no right to sell the asset, and use the proceeds of sale to pay the outstanding debt. The right to retain the property is a form of legal “arm twisting”, hopefully forcing the debtor to pay up, rather than security against payment not being made.

An equitable lien arises where a court has created a proprietary security interest in an asset without agreement between the parties. Accordingly an equitable lien is not dependent on the creditor having possession of the asset.

A statutory lien is created by a statute and the rights which it covers depend on the terms of the relevant statute.

**Pledge**

A pledge is the delivery of possession of an asset to the creditor by way of security but with ownership of the asset remaining with the pledgor. This contrasts with a mortgage where ownership in the asset is usually passed to the mortgagee and possession remains with the mortgagor.

At common law, the creditor can sell the pledges asset if the pledgor defaults on payment, provided the creditor gives due notice to the pledgor.

Only items capable of being delivered (including documents of title to property, such as bills of lading, and bearer securities) can be pledged. Due to the necessity of delivery to effect a pledge, a debt cannot be pledged. Delivery may be actual or constructive, for example, handing over keys to the warehouse where the pledges goods are kept. The pledge is rarely used in practice, but in specialised transactions or in different jurisdictions it may have an important role.

**Charge**

For practical reasons, most lenders will not want to take possession of a debtor’s assets and debtor will not want to lose control of its assets, especially if they are used in the day-to-day running of its business. Accordingly, a lender will want to take security by obtaining rights over, but not necessarily possession of, specific assets of the debtor as security of the loan.

A charge represents an agreement between a creditor (chargee) and a debtor (chargor) by which a particular asst is appropriated by the chargor to the satisfaction of a debt owed to the creditor. Strictly speaking, charges do not transfer to the chargee legal or beneficial interest in an asset, nor do they confer a right to possession. Instead, the chargee has a right to resort to the asset to realise it towards the payment of the debt; it can be thought of as an encumbrance over the asset.

A charge, in its strict sense, exists only in equity, except in the case of land where a charge must be expressed by way of a legal mortgage.

Charges can either be fixed or floating. The question of a charge’s status can become particularly important on the chargor’s insolvency.

Fixed charges attach immediately to the charged asset (provided that the asset is, or is capable of being, ascertained and definite) and can be granted by anyone, including companies, LLP’s, traditional partnerships and individuals.

The key characteristic of a fixed charge is that it gives the lender control over the charged asset. This control is crucial to the nature of the fixed charge. Without sufficient control by the lender over the asset, the charge will be floating and not fixed.

Typically, a document under which a lender takes a fixed charge will give the lender the right to:

* Prevent the charger from disposing of the asset without the lender’s consent.
* Sell the asset if the chargor defaults udner the loan.
* Require the chargor to maintain the asset in priority to other creditors and thereby satisfy the purpose of taking security.

It is important for the effectiveness of the fixed charge that the charges assets are identified as precisely as possible.

Floating charges hover above a shifting pool of assets. While fixed charges can be created by anyone floating charges can only by created by companies, LLP’s and over certain assets.

A floating charge is a charge on a class of assets, present and future, belonging to a chargor. That class of assets is one which, in the ordinary course of the chargor’s business changes from time to time so when a floating charge is taken, it is contemplated that until some future step is taken by, or on behalf of those interested in the charge, the charger will carry on its business in the ordinary way in relation to that class of assets (including disposing of those assets) without the consent of the chargeholder.

The holder of a fixed charge enjoys considerable advantage, in terms of priority of distribution.

Charges can also be taken against book debts (unpaid invoices) and bank accounts.

**Mortgage**

A mortgage involves transfer of title to an asset by way of security for particular obligations on the express or implied condition that it will be re-transferred when the secured obligations are discharged. What distinguishes a mortgage from an outright sale with a right of repurchase is the intention that the transfer is to secure the performance of obligations, for example, the repayment of a debt. The transfer of title enhances the lender’s ability to realise the security, and prevents the mortgagor from disposing of the asset.

A mortgage is an enhanced type of charge because it gives the security holder rights over the asset backed up with a transfer of title. Possession of the secured asset is not required and mortgages can be applied to tangible and intangible assets.

There are two types of mortgage:

* Legal mortgage.
* Equitable mortgage.

The legal mortgage is the most secure and comprehensive form of security interest. Its transfers legal title to the lender (the mortgagee) and prevents the mortgagor from dealing with the mortgaged asset while it is subject to the mortgage. A legal mortgage of land does not get a legal estate in the land, but it is put in the same position as if he had been granted a lease for 3,000 years.

An equitable mortgage involved the transfer of beneficial title in an asset to the creditor by way of security for the discharge of a liability. There must be evidence that the mortgagor intends to transfer beneficial title to the creditor by way of security, and the assets which are to be the subject of the security must be sufficiently identified. In general, an equitable mortgage arises where one of the following applies:

* The formalities necessary to create a legal mortgage have not been complied with.
* The parties merely entered into an agreement to create a legal mortgage in the future over the asset in question.
* The property to be mortgaged is recognised only in equity.

**Issues to be aware of when taking security**

When taking security it is important to consider both what and whose liabilities the security will secure.

Under English law, all present and future monetary claims can be secured whether they are actual or contingent claims. There is no need t specify a maximum amount or a maturity date.

The liabilities secured (commonly known as secured liabilities) will be one of the following:

* All monies
* Specific liabilities.

If the security is all monies, this means that all liabilities and obligations owned by the security provider (and/or a third party) to the lender will be secured by the security.

If, however, the security is for specific liabilities, this means that only certain liabilities and obligations (as defined in the relevant security document) owed by the security provider (and./or a third party) to the lender will be secured by that security. For example, the liabilities secured may be those owing under a facility agreement, a bond issue or an indemnity.

**Recommendation**

A bond which is drafted sufficiently precisely would be the preferred option for security repayment of the loan in the event that the applicant is in default of the contract. .If the applicant went into administration then a demand can be made on the bond and the money would be paid. If one of the other options were used there may be a waiting period for the return of the money while the assets are dealt with. However, with security we have a greater priority than those creditors who do not have any security.

If the bond is not viable for the applicant due to the expense then a legal mortgage would be the preferred second option as it is the most secure and comprehensive form of security interest as the lender will obtain legal title and enhances the lender’s ability to realise the security. We would need to know that the asset is sufficiently valuable to cover the loan amount.