LEGAL UPDATE

FB ATTORNEYS

19 April 2023

Borrower Held Liable for Outstanding Balance on Insufficient Mortgaged Security

- **Court of Appeal rules in favour of lenders on a loan security matter**
- **Lender's bonafide realization of mortgaged property is good defence**
- **Third party mortgagor discharged upon sale of the property, borrower may still be liable**

On 12 April 2023, the Court of Appeal (COA) reaffirmed its previous position regarding liability of the borrower who pledged a security that turned out to be insufficient at the time of realization of the property. The factual background of the case is that the bank had sued the borrower in the High Court of Tanzania (Court) for breach of a loan agreement. The bank issued to the third party mortgagor a statutory notice of intention to offer for sale the mortgaged property in a public auction. The sale by auction did not extinguish the total loan amount including interest that was outstanding and the bank decided to further pursue the borrower for the balance.

The bank thus instituted a suit claiming for the balance plus interest and other charges arising from the borrower's default. A judgment was pronounced at the High Court against the bank and the trial Judge (the Judge) was of the view that the bank was not entitled to recover the balance amount after having realized amounts from the sale of the mortgaged property.

The Judge held that the bank could not go back to Court to recover the loan by other means other than the security it accepted if the value of the security does not cover or falls short of the amount specified in the facility letter or if the bank disposes of the security at a price less than the specified amount. The Court held that the bank had to blame itself for undervaluing the security either before accepting the same or at the time of sale. After losing the suit, the bank undeterredly appealed to the COA vide Civil Appeal No. 214 of 2019.

The COA held that the trial Court erred in holding that the Appellant could not claim from the Respondent the balance of the outstanding credit facility which remained due after receipt of the amount realized from the sale of the mortgaged property. The COA further ruled that, the Respondent had the obligation of repaying the whole amount of the credit facility, including interest and penalties in case of default of repayment according to the agreed schedule. In that regard, where the mortgaged property is auctioned and the purchase price during auction does not satisfy the debt, in the absence of evidence of bad faith or fraud in the conduct of the auction, the lender has a right to claim for the balance of the outstanding amount from the borrower.

Since the mortgagor in the case at hand was not the beneficiary of the credit facility, he was thus discharged from the liability arising from the credit facility after the sale of his property. The COA declared that it was the borrower who had the primary obligation to fully repay the credit facility and, therefore, the bank was justified to claim the outstanding balance.

A welcome decision by the COA for banks that have been struggling to recover loans, which is one of the causes of high interest rates in the market.

To read the Judgment click here

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