FINANCING MINERAL PROJECTS

By G.H. Fewster

The tendency over the last 25 years or so, no doubt dictated by necessity, for mineral ventures to be developed in a short space of time to optimum productive capacity rather than to be allowed to grow, Topsy-like, and to a large extent with self-generated funds, has led to the development of techniques of financing which are somewhat novel.

In ancient times slaves provided, literally, the working capital of mineral enterprises. A hundred years or so ago, grub-staking was a popular method of funding the gold-seeker, with the prospect of rich rewards, or none at all, for the financier. However, changes of philosophical approach have led to the virtual exhaustion of resources in the slave trade and grub-staking has become less attractive to financiers and in any event is not entirely appropriate to enterprises where the equipment required is more than a couple of picks and shovels.

There are very many mining enterprises in existence which from time to time require finance, sometimes in substantial quantities. But they are going concerns and, in general, raise funds in more or less traditional ways. It is not this type of financing with which this paper is concerned. I propose to consider the new project, where there has been little more than exploratory and proving work and where funds are required to establish the enterprise.

The new project of the kind I propose to deal with is distinguished by the vast quantity of funds it requires and the consequent necessity to find those funds from a multiplicity of sources. Mineral projects are not, of course, unique in this respect and there are many other types of project which require similar financing, such as dams and power stations. However, in general it is probably true that, at least so far as Australia is concerned, mineral projects have led the way in the development of suitable financing arrangements.

An examination of the financing of a large mineral project involves the consideration of a great variety of aspects. Like the son of the Sultan who has just inherited his father's harem, I know what to do, but I'm not sure where to start. If, therefore, I seem to meander through the topic it is because there is no entirely logical sequence in which to deal with its multifarious aspects.

Perhaps what principally distinguishes this type of financing is that loans are made on the basis of the estimated success of the project rather than the creditworthiness of the borrower. In many, if not most, cases, the borrower is a company which has no other business or assets. Its sole raison d'etre is the project. It has no financial history, no income, nothing but a future prospect.

The company may indeed have impeccable parentage, but it is not usual to find the parent company assuming the role of guarantor of the borrowings. Typically, the parent company will provide equity investment in the project, sometimes of a substantial amount. It may also provide some loan monies. What is probably most important from a lender's point of view is that it will provide expert management and often a great wealth of mining experience. The parent may also undertake to provide additional funds if necessary to complete the project or bring it to its planned productive capacity. But seldom will it stand behind its offspring to the extent of assuming the latter's financial obligations in the event of default.

Lenders will thus look, initially, to the financial involvement of the company's shareholders. They will be concerned to see, in general, that the shareholders' equity investment is sufficiently large to be likely to ensure the continued interest of those shareholders in the project and a desire to do all that is possible to see that it is a success. Lenders will probably require that the whole or a major part of the equity be contributed before any part of the loans is advanced. If they have persuaded the sponsors of the project to assume responsibility for providing additional funds in case of need they will also require that the obligation to do so is clearly recorded.

However, as I mentioned earlier, the principal feature of project financing is that lenders look to the viability of the project. They are therefore greatly concerned with cash generation and, consequently, with the arrangements for the sale of production from the project.

In the case of an Australian project at least, and probably in the case of most other projects, the bulk, if not all, of the production will be sold in overseas markets. So far as Australia is concerned, the principal market is most likely to be Japan, but there are many other countries to which production may be sold.

Lenders will want to see that firm contracts for the sale of a substantial part of production over a prolonged period are entered into, thus ensuring a cash flow to service the company's borrowings.

Contracts with overseas buyers obviously involve consideration of the laws of the countries concerned, for although it may well be that the contract is expressed to be subject to Australian law, the real test is whether the contract can be adequately enforced in the buyer's domicile.

Additionally, lenders are likely to want to take security over the proceeds of sale, principally to protect those proceeds from the depredations of unsecured creditors, including, perhaps, the buyers. Again the laws of other countries are involved. Some countries do not recognise the concept of floating charges or equitable mortgages and it may be necessary to adopt some system of assignment of debts. This may involve specific notification on each occasion when sales proceeds arise.

Because of the involvement of foreign laws it becomes necessary to obtain the advice of foreign lawyers. This presents no real problems when dealing with a country whose legal system approximates ours, but where the system is substantially different there is an obvious communication problem, heightened by the fact that it is almost inevitable that there will also be language differences. It becomes necessary therefore for the Australian lawyer seeking assistance from a foreign lawyer to ask questions of the latter that would, if asked of another Australian lawyer, suggest that the latter was not only verging on the imbecilic but also of doubtful honesty. But it is only by the asking of repetitive and overlapping questions that there can be any real chance of avoiding misunderstandings.

While lenders, theoretically at least, look to the existence of long term contracts for the sale of production as the primary security for their loans, old habits die hard and the traditional reliance on physical assets to provide security seems to loom paramount, at least in the minds of lawyers. It is therefore to be expected that the documentation of the loans will devote a very substantial part of their contents to the effecting of adequate security over freeholds, leaseholds, plant, machinery and so on, and in this field the lawyer is in his element, for he has a golden opportunity to play with words. Since there are likely to be many lawyers involved, this can lead to drafting problems. I will revert to this aspect later. At this point it seems to me to be not inappropriate to interpolate some comments on the role of government in the establishment and financing of mineral projects.

Since many mining ventures, and nearly all recent Australian ones of any substantial size, are located in remote areas, there will seldom be in existence the necessary facilities either to operate a mine or treatment plant or provide the essential requirements of shelter and recreation for the labour force involved. The uninhabited hinterland will have no power supply or water, no roads, railways, houses, shops, schools or, worst of all, pubs. A popular term encompassing these things is "infrastructure" and while I dislike it because my ill-remembered Latin leads me to have visions of some Stygian edifice, I know of no substitute word that is so well understood and I cannot therefore avoid its use.

Governments being these days impoverished, they are unable to provide the infrastructure that is accepted as part of a modern community and it is thus left to the mining company to provide the requisite facilities. Indeed, it is often the need to provide infrastructure that gives rise to the need for very substantial funds, amounting frequently to hundreds of millions of dollars.

If the company rather than the government is to provide the infrastructure then the company may need some assistance from the government to enable it to do so. If a dam is to be built, the company may need special permission to build it and may need protection against claims from downstream landowners; if the company is to generate power it may need authority to supply that power to employees living at the mine without committing an offence under the local power supply laws; if roads or railways are to be built the government may need to use its powers of compulsory acquisition to assist in some cases; environment protection laws may need to be amelioriated to allow the discharge of wastes and so on.

Perhaps of more fundamental importance is the question of security of tenure in relation to the mineral lease. Generally, mining leases in Australia are of somewhat limited duration and rights of renewal are not as firmly entrenched as is desirable, having regard to the expected life of a mine. It is therefore often necessary to make special arrangements with the government to secure a lease of adequate duration.

Governments sometimes insist that portions of the infrastructure, although provided by the mining company, are at some stage, usually earlier than later, to become government property. For example, a railway provided by the company may on completion be required to be handed over to the government.

In exchange for the things the company is to provide, the government may relax its stamp duty laws and provide certain special exemptions in relation to the project e.g. mortgage duty. It may even guarantee some of the borrowings by the company.

All of these matters require to be dealt with in a way that will be legally effective, for they involve the modification or total disregard of statutes and regulations.

It is not my purpose, here, to discuss the role of government in any detail. But it is a matter which is of fundamental importance in the financing of mineral projects for the whole viability of the project and the willingness of lenders to lend will depend to a large extent on the company's having security of tenure and rights to undertake certain activities that in ordinary circumstances it would be prohibited from doing. Lenders, and, more particularly, their lawyers, are vitally interested not only in the methods adopted by government to provide the required assistance but also, of course, in the precise words.

At the outset I mentioned that I am dealing with large projects requiring vast funds which are obtained from a variety of sources. It is not possible to find funds in such quantities solely within Australia and resort must be had to overseas lenders. Here lies the very essence of project financing. And here arise the problems that the mining company must confront and overcome in order to get the project moving.

Additionally, it is desirable, regardless of whether adequate funds may be available in Australia, to obtain loans in foreign currencies, so as to provide a barrier against the effects of exchange rate fluctuations on the returns from overseas sales of production. Given that most or all sales will be to foreign buyers and that in some cases at least the price will be payable in a foreign currency, either that of the buyer's country or in an international currency such as sterling or U.S. dollars, it is only good sense to attempt as far as possible to obtain borrowings in those currencies and to match to some extent the anticipated sales proceeds with debt commitments. Moreover, many prospective purchasers are willing to lend to a project that will give them a regular source of supply of the product concerned.

If lenders are to be sought throughout the world and if the loans required are of such magnitude that a fairly substantial number of lenders is required, it is obvious that the foremost problem is to draw the lenders together into some sort of orderly formation so as to minimise the chaos: it is impossible to avoid it altogether.

The things that require, basically, to be determined are the inter-relation of the lenders with regard to the times of the making of their loans; their respective rankings so far as payment and security are concerned; and, most importantly the structure and content of the documentation.

From a practical point of view probably the most significant matter is the structure of the documentation. It is important, for two principal reasons, that as far as possible lenders be brought under the same "umbrella" of documents. First of all, from the company's point of view, it must spend the early part of its life at least conforming to the requirements and limitations imposed on it by lenders. Any document providing for a large loan will contain a host of covenants by the borrower – requiring it to do certain things and refrain from doing others. Unless there is a very large degree of commonality amongst lenders and the covenants each seeks to obtain, not only will the company's task be difficult but it may well be that the requirements of different lenders will result in conflicting obligations on the part of the company.

It is no small task for a company whose main object is to operate a successful mining project to adhere to all the requirements imposed on it by lenders. So widely are these requirements drawn that almost everything the company does is likely to be affected in some way by the terms of the lending. If there is a multiplicity of terms, then the company's task becomes that much harder.

Secondly, from the lenders' point of view, each is jealous to see that the others gain no unintended advantage by reason of some fundamental difference in the form or content of the documentation. The more sophisticated lender is also concerned to see that, to a substantial degree, all lenders are bound to act in concert, or at least that the will of the substantial majority can prevail over that of the individual or small group of individuals. A number of lenders who are prepared to waive a breach or overlook a default by the borrower does not want to see the project brought down by the actions of a few, whose loans may be of relatively minor proportions and who may not even suffer loss as a result if, for example, they have the benefit of a government guarantee.

It is thus of great importance that the documentation should, as far as possible, deal with all lenders of equal ranking in a precisely similar manner. This can be achieved by having one basic document containing all the provisions that are to apply to lenders generally. Subsidiary documents are then appended to the basic document as supplements to it, each dealing individually with the special provisions applicable to the particular loan to which it relates.

Basically, a subsidiary document will record the amount of the particular loan, the interest rate and the terms of repayment – all matters which inevitably will vary amongst lenders. In addition, it may contain special provisions which the particular lender requires and which are not contained in the basic document. Obviously it is desirable that these special provisions be kept to a minimum, and if a sufficient number of lenders require the provisions it is more practical to include them in the basic document. On the other hand, if only one or two lenders require the special provisions, the borrower's life is made easier by having to deal only with a small number of lenders should any alleviation of the obligations imposed be required. Moreover, once the loans of the lenders concerned are fully repaid the borrower can thereafter disregard the special provisions and if the lenders concerned have made shorter term loans this can be a significant benefit.

Where there are different categories of lenders e.g. senior or first mortgage lenders and subordinated or second mortgage or unsecured lenders, a separate "set" of documents will be required for each class. In addition, an agreement amongst all the lenders may be required to ensure that there is a contractual relationship between them and their respective rights can be adequately enforced inter se.

It should not be thought that the documentation of a number of loans in the manner referred to resolves all the problems confronting the borrower. Indeed, initially it can lead to as many difficulties as it avoids.

I referred briefly, above, to the drafting problems that arise when there is a multiplicity of lenders and therefore a multiplicity of lawyers. It is these problems of drafting which give rise to the initial difficulties which arise in the preparation of "umbrella" documentation.

No lawyer worth his salt will ever accept another lawyer's document in the form submitted. Unless he makes a reasonable number of alterations his client may well think he is not doing his job and query his fee. More seriously, with the best will in the world, no two lawyers are ever likely to agree initially on the contents of a first draft. Each will have his own ideas and in most cases they will be sensible and practical ideas. Where only two parties are involved the task of reaching agreement is not overly difficult. Where twenty are involved the difficulty increases with geometric progression. Each change in drafting agreed between a lender and the borrower must be referred to all lenders who have previously agreed on the contents of the document. Some of those will agree with the change in principle but ask for some drafting alteration. And so the process must be repeated and all changes and changes to changes and modifications to alterations of amendments to changes continuously circulated amongst the lenders and their lawyers until a consensus is reached, perhaps as a result of sheer exhaustion of all concerned.

It is perhaps appropriate at this stage to give a word of warning. The documents used for project financing ought not to be examined with a view to discovering the beauties of the English language or enjoying the elegant drafting of a competent lawyer. Only disappointment will result. Such documents are the product of a multitude of drafting styles and represent a series of compromises. If a perusal can lead to the discovery of no inconsistencies that should be satisfaction enough. What is likely to be produced is a practical, workable document. Iambic pentameters or Shakesperean prose are most likely to be noticeably absent.

I think it is customary in the case of project financing for there to be a departure from the normal rule that it is the lender's privilege to prepare the documents. In general no single lender has the motivation or patience to undertake the task of marshalling all the lenders and obtaining their agreement to the contents of the documentation. This is more appropriately the task of the borrower. It is the borrower who has sought out the lenders and, probably alone, has direct contact with them all.

There are, of course, cases where a particular, usually substantial, lender or even a non-lending intermediary, will take responsibility for assembling the whole financing package, but this is not usual. More likely will it be that several leading lenders will head up syndicates consisting of a number of small lenders, but the effect of this is to reduce the number of parties involved, not to avoid altogether the need for multiple negotiations.

Lenders will usually like to see the documentation provide for some sort of co-ordinated administration of the loans and the performance of the obligations of the borrower. This can be achieved in a variety of ways. A leading lender or an independent non-lender institution may be given the role of administrator. It may be in the capacity of a trustee or something less onerous, such as agent or representative of the lenders. This is, of course, no novel concept, for the common form of public borrowing on the basis of a trust deed administered by a trustee who, broadly speaking, can act or refrain from acting according to his view of the interests of all lenders, is in fact founded on similar principles. But what is novel is that lenders who in the past have tended to act alone in making loans and call their respective tunes are equating themselves in some respects with the man in the street and the little old ladies who are only too happy to leave it to a trustee to be the policeman.

The powers and discretions of the administrator of project loans can vary considerably from case to case, but seldom is he given the extensive powers that are customarily given to the trustee of an issue to the public of debentures or unsecured notes. Major lenders like to have a direct voice on important matters and it is therefore usual to find the role of the administrator more in the nature of a co-ordinator with some limited powers and discretions rather than an arbiter and enforcer, largely unfettered in the exercise of his administrative and overseeing role.

It is also important from the borrower's point of view that there should be an administrator or agent of the lenders. The loan documents will provide many restrictions on the borrower and should also provide machinery for the relaxation of those provisions in certain events e.g. where there has been a change of circumstances or where something unforeseen occurs. It is also desirable to provide a procedure for the waiving of breaches. Where changes that may have important effects on the project take place or where the breach is a substantial one, lenders will, in general wish to be consulted and have the right to give or withhold approval of some proposed action or to decide whether or not to excuse the breach. Where there is a substantial number of lenders it can take considerable time and effort to notify them all and obtain their views and if the matter is important enough lengthy discussions or meetings may be required. It is therefore highly desirable from the borrower's point of view that the administrator or agent should have the power to give consents and waivers where the matter is of a minor nature unlikely to have any significant effect on the project or the lenders. For example, if the borrower has given a fixed charge over the mining lease, which usually includes the township, and wishes to have the township post office site released from the charge to enable it to be transferred to the Commonwealth, no lender could have any real objection, for neither the project nor the lender's security could be materially affected. It is therefore in the interest of all concerned that the administrator of the loans should have the power to give the necessary release.

Since, as mentioned above, cash flow usually provides the principal security for the lenders, it is sometimes a part of the lending arrangements that someone other than the borrower should be responsible for the collection and disbursement of sales proceeds as agent. A bank or trustee company or, perhaps, one of the lenders may undertake this task and arrangements are made for all purchasers to make payments to the agent, for the agent to retain out of those payments sufficient funds to meet forthcoming interest and capital payments and to make those payments when due and to hand the balance over to the borrower.

These arrangements can be somewhat complicated, for it is necessary to devise a formula to determine how much the agent is to retain out of the sales proceeds from time to time, having regard to the times and amounts of principal and interest payments becoming due and the estimated times and amounts of future sales proceeds. Provision must also be made for the investment of funds in the agent's hands pending disbursement, having regard to the borrower's concern to see those funds earn a reasonable return and the lenders' concern to ensure the safety of the investment.

If the agent is in Australia the problem is to preserve the hedge against currency fluctuations that arises from the matching of the currency of borrowings and sales, for if the sales proceeds are brought to Australia they must be converted to Australian currency and then re-converted when remitted to overseas lenders. If the agent is not in Australia, then the problem arises that the Reserve Bank imposes certain restrictions on an Australian resident keeping foreign currency abroad and it is necessary therefore to ensure that the arrangements made fall within the Reserve Bank's requirements.

Bringing a proposed mineral project to a stage where it can commence construction requires careful organisation and timing. Lenders will be unwilling to commit themselves unconditionally to making loans until they are assured not only as to the likely technical and financial success of the project, but also that the required funds are available. They cannot, of course, be entirely clear as to the prospects of financial success until all relevant financial calculations can be made. These calculations cannot be made with certainty until all interest rates and repayment schedules are known.

Until the lenders are all committed, at least conditionally, to making their loans the company is unwilling to assume obligations with regard to completion of the project the sale of production or obligations to the Government. Until the company is prepared to accept those obligations the Government may not commit itself to its obligations to the company and until the company has obtained the necessary commitment from the Government lenders will be unwilling to advance loan moneys. It is like a group of people waiting to go through a revolving door, with none of them prepared to move before the others do.

It is therefore necessary to make the carrying out of the obligations of the various parties interested – the company, purchasers, lenders and government, conditional upon certain events. But there must also be one final condition which determines whether or not the wheels of the project are to commence to turn or not. These conditions are interdependent but, in the ultimate, it must be the company which decides whether the "start" button is to be pushed.

It is customary for lenders to require to be furnished with legal opinions as to a variety of matters concerning the borrower and the project and as to the documents and their execution. In a way this is merely doing, in a somewhat more formal and particular fashion, what any lender who engages a lawyer to act for him does. Where a financier lends on the security of a first mortgage of real estate, he relies on his lawyer to ascertain that the title of the borrower is satisfactory, that the mortgage document gives adequate security and proper protection to the lender and that the documents are properly executed. This reliance is implicit in the engaging of a lawyer to act and seldom does a financier ask his lawyer to express an opinion as to those matters – the submission of the documents for execution carries with it the clear assurance by the lawyer that all is in order.

In mining project financing there are likely to be many more aspects requiring investigation than there are in the case of a straightforward loan secured by a mortgage of land. It is understandable therefore, that the lender, being generally fairly experienced in the field, will have a list of particular matters which he requires to be checked and certified to by a lawyer. What to me is inexplicable is why, in these circumstances, the lender almost invariably requires the borrower's lawyer to provide the appropriate certificates or opinions. I should have thought that, while most lawyers will give an honest and expert opinion, regardless of who their client is, the temptation to give a favourable opinion, or at least to minimise or underemphasize any doubtful propositions, so as to assist their client, must make an opinion of the borrower's lawyer open to some suspicion so far as a lender is concerned.

Why does a lender seek to obtain an opinion from the borrower's lawyer rather than a lawyer whom the lender instructs and who would have no motive to express other than the most forthright views? It cannot be the cost, for the borrower invariably pays all the lender's expenses. Seldom can it be that the borrower's lawyer is more familiar with the circumstances and therefore in a better position to give the required opinion, for the lender will usually have engaged a lawyer quite early in the negotiation stage.

There may be some minor matters where a borrower's lawyer is in a better position than a lender's lawyer to express certain opinions, for example matters concerning internal procedures of the borrower's directors or executives, but in general I cannot see that a borrower's lawyer is better fitted to express an opinion than is the lenders. Moreover, I do not consider the lender is in as strong a position relying on the opinion of the borrower's lawyer. There is no contractual relationship and while it may be sufficient in many instances to rely on the principles of *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.* ([1964] A.C. 465), those principles do not apply universally throughout the world and even where they do apply, the necessary elements underlying those principles must first be shown to exist. Proving the contract between client and lawyer is eminently simpler.

I believe lenders in general should consider their position carefully. It seems to me to be far more sensible for them to seek the requisite opinions from their own lawyer rather than from that of the borrower.

The question of which law is to apply to the lending transaction is one which sometimes gives rise to serious debate between lenders and borrower. Where lenders are situated in a number of different countries and where a common set of documents is used for all of them, there must, of course, be one law to govern the relationships between all lenders and the borrower, for otherwise the one provision might be the subject of differing interpretations according to which law is to be applied.

Naturally, each party would prefer that the applicable law be that of his own country, for that is the law he is familiar with. But it seems to me that the obvious choice, unless there are compelling reasons to the contrary, is the law of the country in which the project is situated. It is that country where enforcement is most likely to be required and that country where the substantial part of the physical assets which form the security is situated.

However, there may be occasions where it makes better sense to apply the law of a country other than that where the project is located. If the project is in a developing country, the legal system may not be sufficiently developed to provide adequately for the kinds of problems that can arise; or it may be felt that the political situation is such that fundamental changes in the law are not unlikely and the parties may therefore prefer the certainty of an established and more stable system; or a major lender may be constrained by its constitution or domestic laws from contracting on the basis of a foreign law.

In Australia the incidence of stamp duty on borrowing documents can be of considerable significance in a project involving loans of hundreds of millions of dollars. As mentioned above, it can sometimes be arranged with the government of the state concerned that the project will be exempt from duty in respect of its borrowing documentation. However, that is not an end of the matter, for although the mining company may be incorporated in that state, circumstances can arise as a result of which stamp duty becomes payable in another state e.g. if an original document is brought into that other state, or if the mining company has a parent company incorporated in another state and issues a prospectus which results in the need to lodge with the Corporate Affairs Commission copies of the borrowing documents as material contracts.

It is therefore important to ensure that appropriate steps are taken to avoid stamp duty in states other than that in which the project is located. Thus it may be necessary to see that negotiations are not conducted in any place where the result of so doing would attract duty; it may be necessary to exclude certain assets in other states from the security created by the documents; and it is essential to impose restrictions on the lenders as to the places where executed originals of the documents may be taken.

Where foreign lenders are involved the question of Australian withholding tax will inevitably arise. Many foreign lenders require that they receive their interest in full, free of withholding tax; in other words the borrower must, in effect, bear the burden of the withholding tax. This inevitably leads to a technical problem where the borrowings are secured by a mortgage or charge, for section 261 of the Income Tax Assessment Act renders void any provision of a mortgage which shifts the burden of tax (see Appendix). I know of no satisfactory solution to the problem this section presents, short of amending legislation. As a practical matter, however, it tends to be ignored and, void or not, borrowers seem to abide by a provision requiring them to bear the withholding tax and lenders seem to accept philosophically the unsatisfactory nature of the situation. There is little else they can do.

So far I have dealt with the various matters discussed on the basis that there is only one borrower. That is not always the case and many large mining projects are joint ventures of two or more companies. The multiplication of borrowers does not, in principle, complicate matters. It may be that, in order to give lenders adequate rights and powers, each borrower will need to guarantee repayment by the others. The greatest problem is generally that the number of documents is multiplied by the number of borrowers. The documents will all be substantially identical, but the logistics involved in producing a large volume of substantially identical documents can be quite terrifying. The time required for execution of those documents alone can run into hours.

It is not, of course, essential that a joint venture should borrow on a joint venture basis and a number of large projects has proceeded on the footing that each joint venturer obtains its own loans from lenders of its own choosing. However, I doubt whether in those cases security over the borrower's interest in the project is entirely adequate. Should a borrower default the lender's rights would be exerciseable over only a portion of the project and rights of management and sale may therefore be substantially limited.

It is probably clear from the matters dealt with that the problems that arise in relation to project financing are not novel. There is no mystique. They are everyday problems encountered in a variety of situations. The significant thing is that so many of those problems arise in relation to the one transaction.

At the outset I warned that the subject matter involved a number of somewhat disconnected topics which were not susceptible of particularly organised examination. If nothing more I believe I have adequately demonstrated this.

APPENDIX
SECTION 261 OF THE INCOME TAX ASSESSMENT ACT

(1) A covenant or stipulation in a mortgage, which has or purports to have the purpose or effect of imposing on the mortgagor the obligation of paying income tax on the interest to be paid under the mortgage –

(a) if the mortgage was entered into on or before the thirteenth day of September, One thousand nine hundred and fifteen – shall not be valid to impose on the mortgagor the obligation of paying income tax to any greater amount than the amount (if any) which would have been payable by the mortgagor if his taxable income consisted solely of a sum equivalent to the amount of interest to be paid under the mortgage without taking into account any income tax payable on that interest; and

(b) if the mortgage was entered into after that date – shall be absolutely void.

(2) A covenant or stipulation in a mortgage, whether entered into before or after the commencement of this sub-section, which has or purports to have the purpose or effect of including in or adding to the interest payable, in any specified circumstances, by the mortgagor, any amount in respect of income tax payable by the mortgagee upon the interest to be paid under the mortgage, shall be void to the extent only to which it has or purports to have that purpose or effect.

(3) Where, in any mortgage, provision is made for the reduction of the rate or amount of interest in the event of prompt payment of the interest or in any other circumstances, and for the rate or amount of such reduction to be diminished by or in proportion to any amount of income tax payable by the mortgagee the portion of the provision which provides for that diminution shall be void, and the reduction of the rate or amount of interest shall take effect as if the portion of the provision which provides for that diminution had not been inserted.

(4) Any provision in a mortgage by or under which it is provided that any income tax payable by the mortgagee, or any portion thereof, shall or may be taken into account for the purpose of fixing, measuring, or calculating the rate of interest payable under the mortgage or any reduction or alteration of that rate shall, to the extent to which it provides for income tax to be so taken into account (but not otherwise), be void, whether the provision be in the form of a covenant or agreement to pay interest, or a proviso or a stipulation for an alternative, substituted, or reduced rate of interest in lieu of a higher rate payable by the mortgagor pursuant to any such covenant or agreement, or otherwise.

(5) For the purposes of this section, "mortgage" includes any charge, lien or encumbrance to secure the repayment of money, and any collateral or supplementary agreement, whether in writing or otherwise, and whether or not it be one whereby the terms of any mortgage are varied or supplemented, or the due date for the payment of money secured by mortgage is altered, or an extension of time for payment is granted.