REMOVING MORTGAGE SNAGS WHEN BORROWING WITH YOUR TRUST

Borrowing mortgages on properties, using a trust is not complex if you know the background facts and can clearly describe your requirements to the lender. Alternatively, if you choose (what is usually the better method) to use a proactive mortgage broker, you will have to brief the broker, who will in turn need to brief the lender. You may have to first educate the broker.
The following are some of the important points you need to articulate and have agreement on.
At the time when the first approach is made to the lender, one needs to advise the conditions **you** require. Too often clients do not state any of their requirements, and as a result end up with unsatisfactory borrowing conditions and arrangements. The following are major factors which you need to get agreement on:

Trustees are the Purchasers

That the property is being purchased by a trust, and the names of the trustee/s are stated. The trustee could be a corporate trustee (a company) or alternatively individuals. As the land title and the mortgage are always in the name of the trustee/s, these trustee names need to be disclosed to the bank, so that if the loan is approved, then the ownership and the mortgage documents will be correctly drawn up in the appropriate names.

Mortgage in the Trustee(s) Name

That the mortgage loan should also be taken in the name of the trust. I am amazed at the number of instances where because of the lenders' lack of understanding of the situation, as well as their lack of trust knowledge, they will correctly recognise the trustees' ownership, but wrongly approve the loan in the personal names of the individual (settlors). The trust on the one hand owns the property as its asset, but does not have its corresponding mortgage as its liability. This error, if not corrected, results in a messed situation. Should the trust be sued, it will be difficult for the trustees to justify that its equity is reduced by the mortgage (as unfortunately, it is not registered in the trustees' name). The gifting process (where the settlors will individually wish to gift equity at the rate of $27,000 per annum free of gift duty) will also become problematic as it will not be as clear what their actual net equity is, at any point of time.

Who will Provide Personal Guarantees to the Lenders

It is a normal lenders' requirement that the settlors will be required to provide full personal guarantees as part of the borrowing process. In many years of advisory business, I have only experienced two clients who have been exceptions to this rule, and have not been required to provide personal guarantees. One, because of their high wealth, successfully negotiated with the lender not to provide this, and a lender simply overlooked preparing the paperwork for the second client.

I consider that with corporate trustees, there needs to be at least one 'independent' (i.e. not a beneficiary) professional party inside this company in the capacity of director or shareholder or both. Alternatively where there are people trustees, then one of these parties should be 'independent'. Naturally the settlors cannot permit the lender to require a full personal guarantee from the 'independent' party. However unless this exclusion has been agreed to by the borrower and lender at the application stage, the lenders requirement for full personal guarantees will usually become known to the borrower only when the loan documents are received for signing by their Lawyer. More often than not these documents arrive within a handful of days immediately before settlement day. It will be too late to renegotiate the terms at this 11th hour. The normal outcome is that borrowers will have to either change the company, or change the trust deed to remove the 'independent' party. This results in additional last minute costs, and the security of the trustee role is unnecessarily compromised, because the valuable 'independent' party has of necessity just been eliminated. I also know of situations where the real estate purchasers, having requested the trust for good asset protection as well as tax efficiencies, because of these last minute unexpected snags, have abandoned the proposal for their trust to be the purchaser, and have unwisely purchased into their personal names.

In Whose Name should the Bank Account be Opened

When the trust bank account is opened, the name of the bank account can be stated incorrectly. In the situation of individual person trustees, the bank should open the bank account in the name of "The Trustees in XYZ Trust", or alternatively in the name of "XYZ Trust". Either name is satisfactory. However in the situation of an incorporated company acting as sole corporate trustee, then the bank account should either be opened in this company name as trustee for the trust; eg. ABC Limited as Trustee for ABC Trust, or alternatively simply as ABC Limited.

Conclusion

When using your trust when applying for mortgages, to avoid unnecessary hidden snags, it is imperative that you call at least some of the shots. You need to outline and have agreed in writing with the prospective lender at the commencement of your application, what will be acceptable as well as unacceptable terms of borrowing. Unless you do this, you will surely be in for unwelcome surprises.

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