

Third party funding of investment property purchases

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1. Introduction

1.1 These notes contain a brief explanation of the legal implications of the acquisition of the Investment Property being partly funded by a third party bank rather than from the investor's own resources, and discuss the additional standard form documentation and procedure which will come into operation whenever a third party bank is assisting with the purchase of the Investment Property.

1.2 The Bank will lend the money directly to L&C Pensions or to its nominee as Trustee for the Investor. L&C Pensions (or its nominee) will grant a legal charge over the Investment Property which the loan assists in purchasing. Again this legal charge will be granted in L&C Pensions' capacity as Trustee.

1.3 The key element from the legal and procedural point of view is to restrict L&C Pensions' liability to the third party bank (referred to throughout as a "Bank"). In particular it is necessary to ensure that:

1.3.1 L&C Pensions contracts as Trustee for the Investor, not in its own right

1.3.2 that L&C Pensions cannot be sued by the Bank if there is a failure to repay the Bank or another breach of the conditions of the Bank facility and

1.3.3 that the Bank cannot take steps to have L&C Pensions wound up or declared insolvent

The Bank's sole rights in these circumstances would be to enforce its security over the Investment Property. This is known as "limited recourse lending".

2. Limited Recourse: The Theory

2.1 All of the assets of the Open Pension held by the Trustee(s) are held on behalf of the Investors. L&C Pensions will own very little by way of valuable assets of its own. Accordingly, L&C Pensions cannot incur any liability or accept any responsibility which it would have to pay out of its own resources. It must therefore be fully indemnified in respect of any liability it does incur.

2.2 L&C Pensions' assets as a Trustee are pooled, but are held individually on behalf of each Investor. Accordingly, L&C Pensions cannot enter into any transaction or make any investment which may expose its overall assets to liabilities which relate to only certain Investors or Investment Properties. Discharging a specific liability from the pooled assets would constitute a breach of L&C Pensions' fiduciary duties to the other Investors.

2.3 The theory behind the procedures and documentation to be put in place is that each Bank loan and associated security is isolated and there are no cross default provisions which mean that a failure to pay or a breach of the terms of any Bank loan or security document could constitute a breach of another Bank loan or security document.

2.4 In addition, the relevant Bank's rights to enforce repayment of the loan or compliance with the terms of the loan would be limited, such that the Bank could not sue L&C Pensions or take steps to have it made insolvent. Instead the Bank would have to enforce its security over the particular Investment Property which its loan was used to purchase and use the proceeds of sale to discharge any liability.

3. Bank requirements

3.1 In addition to limiting recourse to L&C Pensions, the procedure and documentation used will have to enable L&C Pensions and the Investor to satisfy the Bank's own requirements for making a loan available. The Bank's internal arrangements will be such that, in order to permit drawdown of the loan it has agreed to make available, it will need to have received certain documentation and will have imposed other investigation related conditions e.g. as to the quality of the Title or Valuation etc. These conditions are generally set out in the Bank's facility agreement as conditions precedent to the loan being advanced. (As to satisfaction of conditions precedent generally, see 4.4).

3.2 Much of the documentation which is required is standard and has therefore been anticipated and is included in the standard package of documents which will be sent to the Bank's Solicitors when instructions are received (see 4.1).

3.3 The documents which the Bank requires will include evidence that the people who are to sign the Bank documentation are duly authorised to do so on behalf of L&C Pensions. For this reason the power of attorney and the copy trust deed and memorandum and articles of association of L&C Pensions are all included within the documentation to be sent to the Bank. The expectation created by this arrangement is that the Bank will be able to accept the signatures of the Attorney to sign all documentation, authorisations and commitments required of L&C Pensions.

4. Limited Recourse and the Bank's Requirements: The Practice

4.1 On receiving instructions in relation to the acquisition of an Investment Property which is to be partly funded by a Bank, L&C Pensions' Solicitors will issue a bundle comprising the following documents:

4.1.1 covering letter to the lender or the lender's Solicitors

4.1.2 notes to lenders and lender's Solicitors

4.1.3 standard form non-recourse deed which isolates the Bank loan and the security as described in paragraph 2 above

4.1.4 copy memorandum and articles of association of L&C Pensions

(together "the Borrowing Standard Package"), and when available:-

4.1.5 The Investor's Solicitors' report on title. This will be the same report on title as is addressed by the Investors Solicitors to L&C Pensions in respect of the Investment Property, but will be addressed by the Investor's Solicitors to the Bank as well as to L&C Pensions and will serve in most cases to avoid the need for further independent investigation of title by the Bank or its Solicitors and

4.1.6 The agreement for lease and lease (in draft form) to be entered into between L&C Pensions and the investor (or its business)

The term "lender" is used rather than Bank throughout the documentation in case the third party lending the money is not a bank. In this case L&C Pensions' Solicitors would have to adapt the bundle of documents depending on the exact nature and identity of the lender. The documents have been drafted on the basis that the most likely type of third party lender is a bank.

4.2 The covering letter (see 4.1.1) asks the Bank to:

4.2.1 supply to L&C Pensions' Solicitors drafts of the proposed bank loan agreement and security document. It will be necessary to check that these documents do not include any clauses which are unduly onerous or unacceptable

4.2.2 supply the necessary details (for example, company numbers) to complete the standard form documentation which has been supplied and

4.2.3 arrange for its Solicitors (if any) to deal directly with the Investor's Solicitors with respect to the report on title. This prevents L&C Pensions or its Solicitors becoming involved in negotiations on the report on title with the Bank's Solicitors as well as the Investor's Solicitors which would obviously increase costs and liaison.

4.3 On receipt of the required information from the Bank's Solicitors, L&C Pensions' Solicitors will:

4.3.1 confirm whether the Bank's draft facility and security document are in an acceptable form, having agreed any necessary amendments

4.3.2 supply to L&C Pensions for execution engrossments of

- A. the Bank facility letter and security documents
- B. the non-recourse deed

4.3.3 supply engrossments to the Bank for execution of the non-recourse deed

4.4 It is essential to note that an acceptable facility letter must be in place prior to L&C Pensions entering into any commitment to purchase Property, and also that any conditions precedent to drawdown have been assessed prior to exchange of contracts to satisfy L&C Pensions that they have been or will be satisfied prior to the contractual completed date. In most cases, exchange and completion of the purchase will be simultaneous.

4.5 All the above documentation will be executed and returned to L&C Pensions' Solicitors to be held undated until completion and strictly to the order of the party who has signed it.

4.6 L&C Pensions' Solicitors will then collate and supply to the Bank all documentation required to satisfy the conditions precedent to drawing of the Bank loan as set out in the Bank's facility letter (which will include where relevant the report on title referred to in 4.1.5), to the extent that these have not already been supplied in the original documentation. This will be forwarded to the Bank's Solicitors by DX or fax as appropriate. The Bank's Solicitors will be asked to confirm that drawdown can accordingly take place.

4.7 Companies House and HM Land Registry registrations will be effected by the Bank or its Solicitors.

5. The Non-Recourse Deed

5.1 When lending, the Bank would generally not have to execute a non-recourse deed. It may not, therefore have the systems in place to review or execute the deed. If, for internal reasons or because of timing, the Bank is unable to execute the non-recourse deed then the relevant provisions from it will have to be included within the Bank facility letter and the Bank security documents instead. These provisions will have the same effect as entering into the non-recourse deed but it may be politically more acceptable for the Bank or, in terms of timing, easier for the Bank to incorporate those provisions within its own documents.

5.2 Nonetheless, it is less convenient and will be more time consuming, and therefore more costly, for standard provisions to be included within the facility and security document rather than simply entering into the non-recourse deed. For this reason, the option of amending the facility and security document rather than entering into the non-recourse deed will not be offered initially.



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**For more information about
L&C Pensions please contact:**

L&C Pensions
38 – 42 Perrymount Road
Haywards Heath
West Sussex
RH16 3DN

Tel: 0870 7566696

Fax: 0870 7566697

Email: info@lcpensions.com

Web: www.lcpensions.com

