ASSETS

Gary Fitzpatrick, Comac Trustees Ltd

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Lindsay: I'm pleased to introduce Gary Fitzpatrick, a co-owner of Comac Trustees and Pathfinder Advisers Group, both of which are based in Auckland. Gary has over thirty years' experience managing trusts and estates, he's a trustee of various charitable trusts and he is the President of the Estate and Tax Planning Council in Auckland.

Gary, what do trustees need to be thinking about when they're managing trust property and assets?

Gary Fitzpatrick: Thanks Lindsay. There are a number of things that trustees need to be thinking about in managing their trust property and I'll cover what I think are the more important ones.

First up, trustees have to know what property they're responsible for and make sure it is correctly held under their control. When we review a trust, it's not unusual to find that while a trust has been set up correctly, the assets aren't correctly held in the names of the current trustees of the trust. For example, if the trustees own a house property, the Certificate of Title for the property may not record the current trustees as the legal owners.

It's important when the trustees accept assets into trust (or when a new person is appointed as a trustee), that the trustees know the assets they are responsible for and check that the ownership to those assets is held in the names of the trustees.

As part of bringing the assets under their control, trustees need to make sure all trust assets are adequately insured and that their risks are covered. Insurance policies need to be in the trustees names and reviewed at least annually.

Trustees then need to know the condition of their trust assets and be satisfied that they are being appropriately maintained or looked after. The condition of some types of assets can deteriorate very quickly. Examples would be vacant or tenanted real estate property assets.

Lindsay: I agree it's not unusual to find either the title to assets or insurance policies in the wrong names. Having managed a trust which had a tenanted house completely destroyed by fire, I can only reinforce the need to keep insurances under close review, make sure all risks are covered, and know what the property is constructed out of and what current condition it is in.

Gary: You're right and once the trustees know the condition of their property and have got it secured, they then need to decide how the

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trust property will be used, and how the beneficiaries will benefit from that property. Sometimes it will be obvious, but there are times when it's not quite so easy to identify both aspects. For example, I've seen trusts where people who were not beneficiaries of the trust have benefited from the use of trust property.

As part of deciding how trust assets are going to be used to benefit the beneficiaries, the trustees should consider as part of their decision process any wishes that the settlors of the trust may have made known to them about how trust property was to be used or managed.

Lindsay: So to recap, if you're a trustee, you need to know what assets or property you're responsible for, you need to get them under control or secure, and not only manage them properly, but ensure they are used for the benefit of the trust beneficiaries. What are some problems that you've come across with the way you've seen trustees manage their assets?

Gary: Most problems I see often come down to the way trustees manage their risk. Risk can be inherent in the type of asset being held or it may come about from the way trustees do their job. I talked earlier about trustees knowing the condition of assets and making sure they were being maintained.

Real estate property assets are one area where I often see problems. Some trustees have never inspected their real estate assets (or asked for inspection reports), so they have no idea what condition they're in, how well they're being maintained or even if the insurance covers are adequate. Trustees need to know the condition, who is occupying the property and the terms of occupation (for example if the property is occupied by settlors, a beach property, tenanted home or leased commercial property).

Trustees should also pay close attention to the maintenance of vacant real estate properties. Vacant properties can deteriorate easily and it is important lawns are mowed, gardens are done, mailboxes are cleared and the insurance company notified that it's vacant.

Lindsay: And with real estate property assets, trustees also need to think about what sort of maintenance costs might be coming up, for example, if they have to replace a roof in five years…

Gary: Absolutely and that touches on some of the longer term aspects for managing real estate property – having a plan to fund on-going maintenance or repairs that might be looming or arise unexpectedly. If you think about recent earthquakes in Christchurch and Wellington, trustees with commercial property in those areas may have buildings that have to be improved to comply with the required earthquake standards. You'd want to know what you are up for and

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when it has to be done by.

Another common problem is where trustees managing property assets do not stay on top of the income streams. For example, a rent review date might be missed, rental might not be collected or the tenants might not abide by their obligations correctly. This work is often delegated to an agent of the trustees, but the trustees still need to oversee things and ensure that it's all being taken care of. That's where a diary system is useful to ensure key dates and follow-ups are not overlooked.

Lindsay: That's certainly an area where I've seen problems for trustees, especially where family members occupy trust properties. Family arrangements can often start off with the best of intentions but problems can arise if the rental stops being paid or if there's a problem with doing agreed maintenance. If the trustees let problems drift or expect "the family" to sort it out, it can often create tensions and more problems. Trustees need to stay on top of situations like that.

Gary: That's a good example. A problem relating to that is where conflicts of interest can potentially arise, say where trustees are looking at selling trust assets to people who have a relationship with the trust (for example, family members, or beneficiaries of the trust). Trustees need to take special care in these situations and watch closely for any real or perceived conflicts of interest. In these situations it's essential for trustees to know what the trust deed authorises them to do.

It can also be a good idea to get an independent valuation of the asset being sold to support the decision. I'd also recommend that after the trustee have signed a resolution for the decision they've made, that they separately attach to the Trust File any other information or professional advice that they used, considered or relied on as part of their decision process (for example, they may have obtained a registered valuation or legal advice). I take the view that more information (including the process the trustees have used to reach their decision), is better than less.

I'd also recommend that trustees keep a keen eye out for any intermingling of trust assets, trust income and payments made on behalf of the trust. It's something we see a lot of and it can easily happen when personal assets, income or payments get mixed up with trust assets, income or payments. It is very important that trustees keep trust assets very separate from any personal assets of the parties involved or associated with the trust.

Lindsay: That's where a separate trust bank account is important…

Gary: And where all trustees need to monitor the bank account. It's important with any trust bank accounts that all trustees know

strategies for trusts

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what's going on, who has signing authority and what transactions are taking place. It's too dangerous for one trustee (often an independent trustee), to just sit back and leave it to one or two of their co-trustees to operate the trust bank accounts.

You also often see this sort of behaviour with decision making in trusts. It's where some trustees (usually the independent trustees) sit back and blindly let other trustees (who are usually the settlor/co-trustees) run things and make the decisions or commitments for the trust. The trustees who sit back often only get to be involved when they're asked to sign documents for decisions their co-trustees have already made. By not being actively involved, they often don't understand what's been going on.

We call this sort of behaviour "rubber-stamping" and it's a really dangerous thing for a trustee to do. We'd recommend that those sorts of trustees are better off resigning as a trustee. It's clear many trustees just aren't aware of their personal risk when managing trust assets on behalf of beneficiaries.

Lindsay: Gary, I agree and I know some of those trustees you're describing are professional advisers. Why take the risk? Are there any other problems you want to touch on?

Gary: The final problem I'll comment on involves some more complex issues that can arise when the trustees own shares in a private company. I sometimes meet trustees with private company shares as an asset of the trust who don't always have an understanding or knowledge of how the company works. The company may have been set up by the settlor, may be controlled by the settlor and the company shares are an asset of the trust.

As a trustee you do have responsibilities and obligations as a shareholder and keeping close oversight of private company shares is very important. I'd recommend trustees should consider obtaining good directors reports, copies of the financial accounts for the company, perhaps ask to meet periodically with the company directors or consult with the trust's advisors from time to time. For example, a time when it would be prudent for the trustees to have more insight and knowledge into what's happening would be when a major transaction is occurring within the company.

Lindsay: So that's about trustees getting advice or putting checks and balances in place to closely oversee any private shareholdings or businesses owned by a trust. Thanks for taking us through those problem areas Gary. Can we now move on to good practices for trustees to manage their trust property and assets? What would you recommend?

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Gary: I think we've covered the main ones. I'd summarise them as:

- Become familiar with the property or assets that you're responsible for and make sure they are held correctly in the names of the trustees.
- Make sure that you are familiar with what's happening with the assets, that you know their condition, their value, how they're being used, that they're secure and that any custody arrangements are appropriate for the circumstances.
- Complete regular inspections or reviews of the assets, annually at a minimum.
- Keep a close eye on higher risk assets, especially where real estate property is involved. It's important to maintain the assets and have close oversight of tenancies, leases and vacant property.
- Review insurances at least annually to check everything is appropriately insured and that the insurance policies are held in the names of the trustees.
- Watch higher risk assets like businesses and private company shares. Ask Directors for reports and copies of financial accounts.
- Check large amounts of cash are invested (and not left to accumulate in bank accounts).
- Ensure the assets held by the trust are appropriate taking into account the terms of the trust deed, the beneficiaries and their specific circumstances.
- Always seek professional advice where you're not sure, where you identify risks for the trustees or where you are required to hold "risky assets" (the trustees may want to consider getting indemnities from the beneficiaries to protect themselves from future claims).
- Be actively involved in the management and all decisions of the trust. Record trustee decisions in writing, signed by all trustees (and support decisions with separate file notes of consultation and inquiry made, advice obtained or reports relied on, on the Trust File).

If I summarise what we've talked about, it comes down to trustees accepting their position of responsibility and if they're going to take on the trustee role, they need to do the job properly and diligently.

Lindsay: Thanks Gary. I appreciate your insights and your time today. If people wish to make contact with you, they can do that through your website www.comac.net.nz.

Gary: You're welcome. I'm pleased to be able to help.