Successful Joint Ventures

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Joint Ventures are flavour of the month. Lenders tightened lending criteria after the credit crunch and recycling your cash became a much harder task. That inevitably means that investors run out of money at some point. There's an abundance of money available so matching up money and deals seems an eminently sensible approach.

Unfortunately, it is not that easy if you are looking to borrow the bulk of your money from lenders. You can do pretty much what you like if you don't want to borrow money but if you want to borrow you need to play by the lenders rules.

Lenders want to see two things: -

1. That the borrower has some skin in the game.

This means that the deposit comes from the borrowers own funds. Excepting a family gift and equity released from other property owned by the borrower the lender wants to see that this money is not borrowed. Whether that be from a third party, loan or credit card.

2. That they know exactly who they are in a relationship with.

When you borrow money from a third party they may have rights to the property as a result and the lender does not know who they have entered in to a relationship with. Therefore, the funds need to come from the applicant(s).

It is **not** acceptable to leave money in your account for a couple of months then actually go and borrow the deposit from JV partners. All applications will ask where the funds have originated from and if you state it is from one source but it is actually from another than that is mortgage fraud – make no bones about this!

Not all lenders ask for proof of deposit though they reserve the right to. I'm aware of a couple of lenders going back over cases from five years ago and asking for retrospective proof of deposit!

Similarly, the structure under which you do these third party arrangements is irrelevant; lenders would not agree to a deed of trust, loan agreement, RX1, etc. if they became aware and not declaring as such brings you back to what is called 'gaining a pecuniary advantage by deception' commonly known as fraud.

A family gift is usually acceptable. Let's say you can't get a B2L mortgage and your brother can. It's fine to give him the deposit money and he buys it or vice versa. The deposit MUST be a true gift and you/they will be required to put that in writing.

Lenders will only accept a gift from a relative (some will accept a gifted deposit from a national house builder) as a gift from another party would not be deemed feasible as a lender would not believe that anyone other than family would gift you money.
It is also important to realise the significance of the relationship you are entering into with your JV partner if you both go on the mortgage or loan together. The relationship is no different to a husband and wife borrowing a mortgage together for example. You are linking your finances together including any financial history not directly related to the loan or mortgage itself. I have had many people contact me to say that their JV partner has gone awol, got into debt, got a CCJ, even gone bankrupt and their credit file has now been affected.

So what **can** you do to maximise other people's money legitimately and safely?

Here's my Top Tips: -

- The first thing to do is to read up on the FCA Guidance on Joint Ventures under their policy PS13/3 – you can find this at:- http://www.fca.org.uk/static/documents/policy-statements/ps13-03.pdf Don't be put off by the title thinking that you are not operating a collective investment scheme as you may well be. The policy covers in particular how the structure is formed, whether it is regulated and importantly how it is promoted.

- By far the best way is to get the JV partner to fund a deal in its entirety. Use the investor funds in full and give them first charge while you retain ownership. This is the easiest if you find investors with big enough sums.

- An alternative to consider is buying jointly with bridging as this is a short term arrangement.

- Always aim, to become the only owner/mortgagor asap.

- Only ever transfer money between solicitors not directly between yourselves to ensure money laundering guidelines are followed and there is a proper money trail; you will get quizzed on it when you come to refinance.

- Be careful if the intention is to keep and refinance the property if you are not the original owner. If you buy it from the JV partner, you will be required to put in a full cash deposit even if it was set up as a JV.

- If you intend to keep the property and refinance onto a B2L mortgage be careful as some lenders won't replace private finance.

- If the JV partner wants to own the property rather than you then buy in their name and you take a fee for sourcing, management etc. Keep it clean and simple.

- If there is a shortfall in refinancing this may cause issues with the lender refusing to allow redemption or refinancing. They will certainly insist that the JV partner absolves all rights and claims so they cannot come after their shortfall later.

- Limited Company finance is no different to ordinary finance - it's about the directors behind the company. Similarly, commercial lenders are no more forgiving; if anything they are stricter.

- I would not recommend that a JV partner makes a loan to a company - if it's a director's loan they must be a director by its very nature and you are in partnership with this person just like on any mortgage as most lenders will request a personal guarantee.

- Do not go into a JV with someone you are not already in a relationship with; family, financial, business partner etc.

- The financial relationship will last many years and at least 7 on your credit files BEYOND the END of the loan.

- Check each other's credit files BEFORE entering into a partnership. A client did this recently upon my advice only to discover the partner had a CCJ!

- Check each other's credit files at least quarterly for early signs of problems.

- Provide each other with ALL bank account statements before entering into the JV and at least quarterly. Look for missed payments, exceeding overdraft limits etc. If you would not provide these to your JV partner and they would not provide them to you then why the heck would you go into a financial relationship with each other?

- Use a solicitor to draw up a robust JV agreement for every eventuality; divorce, marriage, falling out, dissolution, bankruptcy, mental incapacity, illness, imprisonment, death. I have come across ALL of these!

- Insure each other appropriately with life insurance; this can prove expensive however subject to age and health so the earlier the better. The aim of insurance should be to buy out your partners share from their estate so that you do not end up in a partnership with someone you did not intend to in the event of their death. This might be their spouse, kids or the dogs home!

- Remember you will be acquiring their share so inheritance tax and SDLT must also be considered.

- If inheritance tax hasn't been accounted for, then the properties may have to be sold to pay the tax. This could impact the remaining party and their plans significantly. Again life insurance could be taken out to cover this tax.

- Solicitors have a tendency to place properties in joint ownership automatically. This means that each party owns an equal share and should one party die the property automatically reverts to the other party. If the intention is for family or another person to inherit their share, then the ownership needs to be set up as Tenants in Common instead. The share between the parties can be set up in any percentage you like from 50/50 to 99.9% to 0.01%. Do bear in mind however that should you set up the arrangement in this way the property share goes into the individual's estate and is then owned accordingly by the estate beneficiaries.

- A final caution; the new tax changes may find you or your 'expected to be silent' JV partner saddled with a tax bill they didn't expect as THEIR non-property related income now comes into play whereas it didn't previously. You need to cover off who is responsible for paying this and perhaps apportion the property ownership accordingly at the start.

In summary Joint Ventures can be a profitable win:win but they must be structured correctly with full disclosure and a full understanding by all parties of the risks as well as the rewards.

Lisa Orme is an experienced property developer, investor and mortgage broker and specialises in property and financial services for new and established property investors.

*If you'd like to discuss your property investment strategy or indeed any mortgage or financial requirements you can contact Lisa at **lisa@keys-mortgages.com** or call **02476455445**.*