

BUTELAW

(John Rust & Associates)
LAWYERS

25A Bute Road, Browns Bay
PO Box 35 563, Browns Bay • DX BP 62017 Browns Bay
Telephone: (09) 476 4280 • Fax: (09) 476 4286
[Email: john@butelaw.co.nz](mailto:john@butelaw.co.nz) • www.butelaw.co.nz

NEWSLETTER

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Reverse Mortgages

For many New Zealanders, the family home is their most valuable asset. For some people this can mean they are asset rich but cash poor. It is such people who are being targeted in marketing campaigns for reverse mortgages. These mortgages are relatively new in New Zealand and can have serious implications for the home owner.

What are they?

Reverse mortgages usually involve a loan borrowed against the equity in the home owner's property. Generally, the loan is repayable on the sale of the property or upon the owner's death, whichever occurs first. They are particularly attractive to people who have retired and whose home is mortgage free.



How much do reverse mortgages cost?

Reverse mortgage schemes are often advertised on the basis that there are no regular repayments. Whilst this is true, interest and fees are still charged for so long as the loan continues and are added to the balance, which will ultimately have to be repaid. The interest rate will usually be higher than an average bank loan. There may also be fees payable in addition to interest and these can include a valuation fee, commission (e.g. to a broker), early repayment charges and other costs which may be payable in the event that the home owner decides to sell the home.

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Be aware of the downside

Advertising for reverse mortgages is often presented in attractive terms, which suggest that money can be made available to fund things that most people desire, such as holidays, home renovations and travel.

While reverse mortgages can make it possible to obtain money from the family home for these purposes, the cost is significant.

Most importantly, the increasing value of your home may not keep pace with the debt owed under the terms of the mortgage. Interest may compound. The amount owing will continue to increase the longer the loan remains unpaid. This will not present a problem so long as you continue to live in your home. However, if you wish to sell your home then the mortgage will be repayable and you may find that the amount that you receive after repaying the loan is insufficient to enable you to buy another home of an equivalent standard.

Managing a Subdivision

Subdivision of land can be a complex and expensive process that requires careful planning. Oversights in the process can lead to delays and omissions which will inevitably impact on costs. For this reason a subdivision requires a team effort from those involved. These parties include your surveyor, the local Council, your lawyer, your accountant and various contracting companies.

Ideally, you should instruct your lawyer to oversee the process from the very start. This will minimise risks or delays by ensuring a line of communication exists between the various parties involved.

Some key issues:

If you don't already own the land:

a) An agreement for the purchase of land that is to be subdivided will need to be prepared. This can be a complex document. In particular, there may be cash flow and taxation issues to consider and your lawyer and accountant will need to work together to ensure those issues are adequately dealt with in the agreement.

b) A due diligence investigation will need to be undertaken. This can be completed either before or after an agreement has been signed. However, most developers will not wish to incur costs unless they are able to secure the land first. The purpose of due diligence is to investigate the feasibility of the subdivision taking into account the costs, the time it will take and the ultimate return to the developer.

For existing landowners wishing to subdivide, check whether the current ownership status is appropriate for completion of the subdivision, particularly for tax implications.

Seek advice

If you are contemplating taking out a reverse mortgage, it is absolutely vital that you obtain independent advice from your lawyer, and fully understand the terms of the loan and the long term implications for you. Reputable companies offering reverse mortgages will require you to take independent advice before proceeding.

Although the Government has indicated that a code of practice is to be established for reverse mortgage schemes, it is not yet in place. Home owners should be wary of any reverse mortgage scheme which does not state that it is mandatory for the home owner to obtain independent legal advice before proceeding.

Confidentiality: subdivisions can be a sensitive issue, particularly where neighbours are concerned. Parties involved in the due diligence process should be aware of the importance of not disclosing the proposal to third parties until a decision has been made whether or not to proceed.

Check the title: your lawyer can provide you with a detailed analysis of the title at the outset. Analysis can include information on restrictions that run with the land (e.g. easements) and whether or not those restrictions are compatible with the purpose and layout of the subdivision.

Sale of sections

Regardless of whether the subdivision involves the sale of one or fifty sections, it is prudent to decide at the outset how



the sales will be managed. This process includes:

- Setting a date for the sale of sections.
- Ensuring the agreements for sale of the sections reflect the stage at which that the subdivision has reached.
- Briefing and appointing real estate agents.
- Setting the amount of the deposit to be paid by a prospective purchaser and the point at which those funds can be released to fund the ongoing costs of the subdivision.

Conclusion

Planning and co-ordination are vital for a successful subdivision. Your lawyer's involvement throughout the subdividing process will ensure that delays are minimised and benefits maximised.

The “Anti-Smacking” Bill

The current position

Section 59 of the Crimes Act 1961 (“Section 59”) allows parents and any person in place of a parent justification to use reasonable force against a child for correctional purposes.

The proposed changes

In June 2005, the Crimes (Abolition of Force as a Justification for Child Discipline) Amendment Members Bill (“the Bill”) was introduced to Parliament by Green Party MP Sue Bradford. The Bill originally sought to repeal Section 59 entirely, removing reasonable force used against children for correction purposes as a defence to offences involving assault. The effect of repealing Section 59 is that the defence of reasonable force against a child for the purposes of correction would not be available to parents. Instead, the use of force against a child would have the same legal ramifications as the use of the force against an adult.

In November 2006 following referral to Select Committee, the Justice and Electoral Committee (“the Committee”) reported back to Parliament recommending by majority that the Bill be passed subject to recommended amendments. The substantive amendment recommended by the Committee does not envisage an outright repeal of Section 59. Rather, the Committee recommends that Section 59 be replaced with a provision enabling reasonable force to be used against children for purposes such as protecting a child from harm, providing normal daily care and preventing a child from doing harm to others.

The international position

The United Nations Convention on the Rights of the Child (“the Convention”) was ratified by New

Zealand in March 1993. The UN Committee on the Rights of Child issued a general comment in June 2006 concerning the use of violence against children. The comment emphasised elimination of violence and humiliating punishment of children through law reform and other measures as an immediate and unqualified obligation for ratifying states of the Convention. More than a third of European countries now afford children equal protection from assault including Germany, Norway and Sweden. The Bill, if adopted by Parliament, will be a step towards aligning New Zealand with its commitments under the Convention.

Interestingly, United Kingdom legislation is at odds with this trend towards equal protection for children from assault. United Kingdom legislation that came into force on 15 January 2005 allows the assault of children to continue to be justified as “reasonable punishment”. The United Kingdom has twice been rebuked by the UN Committee on the Rights of the Child since it ratified the Convention in 1991 for failing to afford children equal protection from assault.

Conclusion

It is clear that parental rights to chastise children and the rights of children to be protected from violence are at odds with one another. It is also clear that the issues the debate raises are sensitive and topical having received a fair degree of media attention. The Committee received 1,718 submissions on the Bill prior to issuing its report of which 1,471 came from individuals and 248 from organisations. However, it does appear likely that the Bill will be adopted by Parliament in one form or another.



Trusts – The Paperwork is Crucial!

Trusts are a popular choice for people who are concerned about protecting their assets for themselves and for their children. However, the formation of a trust by the execution of a trust deed and transfer of assets to the trust is only the start. A successful trust is one that is regularly monitored by the trustees and where there is a clear paper trail evidencing the ongoing administration of the trust by the trustees.

Why the need for paperwork?

If the trust is not properly administered, there is a risk that it may be seen to have either “lapsed” or that it is simply a “sham”. This usually occurs where the assets which form part of the trust fund are treated by the trustees as if they are their own personal property held for their own benefit rather than assets held by them for the benefit of the beneficiaries of the trust. Given that trustees are

frequently both trustees and beneficiaries of the trust, it is all the more important that a clear distinction exists in the minds of the trustees regarding assets which are held by them personally and those which belong to the trust.

Essential paperwork

The administration of a trust will depend very much on the nature of the assets which make up the trust fund. A trust fund that consists of the family home in which the beneficiaries reside will not require the trustees to do a great deal for so long as that situation continues. If there is a debt owing by the trust to the settlors of the trust (i.e. the persons who originally set up the trust and transferred assets to it) then the debt should be gifted by the settlors in annual increments of \$27,000.00 (for each settlor) until the entire debt has been forgiven. As house prices continue to rise, the gifting process is taking longer and trustees should be vigilant in ensuring that gifting continues as this will maximise the benefit of the asset for the beneficiaries of the trust.



In addition to gifting, trustees should meet at least once a year to review the trust fund and the manner in which the trust fund has been applied for the benefit of the beneficiaries. There may be no need for the trustees to make any decisions but the important point is that:

- a) the trustees have turned their minds to their duties and responsibilities, and
- b) a trustee resolution records how those duties have been discharged over the previous 12 month period.

In the case of trusts that hold income producing assets (such as investment properties and shares), the matters which trustees should attend to include:

- Regularly reviewing the performance of investments.
- Preparing and filing a tax return.
- Ensuring that the trustees meet at least annually and possibly more frequently, depending on the nature of the investments which they are monitoring.
- Ensuring that any new investments and/or transactions that the trust may enter into are properly documented and supported by appropriate resolutions.

Minutes of trustees' meetings should be kept and particular care taken to record decisions taken concerning investment of trust funds and distributions to the beneficiaries.

Conclusion

In summary, the advantages of keeping the paperwork for your trust up to date cannot be overstated. A trust which is properly administered will provide a much greater degree of protection than one which is effectively dormant because the trustees have not turned their minds to their duties and responsibilities under the terms of the trust deed.

If you have any doubts as to whether your trust is being properly maintained, consult your lawyer.

Legal Definitions (Trust Deeds)

Below are some of the terms commonly used in trust deeds:

Trustee(s): The person(s) who are responsible for ensuring that the trust is administered correctly and who hold the trust fund on trust to be applied for the benefit of the named beneficiaries.

Settlor(s): The settlor(s) are the person(s) who establish the trust and transfer assets to it.

Trust Fund: The assets that are transferred to the trust by the settlor and held by the trustees for the beneficiaries.

Beneficiaries: The persons or entities who are entitled to benefit from the trust fund.

Vesting Date: The date upon which all assets held on trust by the trustees must be distributed to the beneficiaries. A vesting date cannot exceed eighty years from the date the trust is established.

Appointor: The person who has the power pursuant to the trust deed to appoint a new trustee or advisory trustee and/or to remove any or all of the trustees.

If you have any questions about the newsletter items, please contact me, I'm here to help