Separation of legal and beneficial ownership of real property is common in the commercial real estate context and a lender must take certain steps to properly secure an interest in real property assets where it is aware of such an arrangement.

A trust exists where there is an asset that is held by a trustee or nominee for the benefit of a third party beneficiary or beneficiaries. Beneficial owners may wish to establish a trust to hold assets where, for example, the beneficiaries do not wish to be disclosed; to facilitate logistics of execution of contracts; or the beneficiaries are not legal entities capable of holding title to real property.

Where a trust structure is utilized, the beneficial owner or owners appoint a trustee or nominee to act as agent for the principal, being the beneficial owners and, in the case of a bare trust, the nominee has no discretion to deal with the asset other than upon the direction of the beneficial owners. In a bare trust, an agency relationship exists between the nominee or trustee and the beneficial owners. Given that the beneficial owners retain authority to deal with the asset and the nominee or trustee acts only upon the direction of the beneficial owners, it is ultimately the beneficial owners who are liable for the debts and obligations incurred by the nominee or trustee.

Notwithstanding the agency relationship, case law has upheld the “sealed contract” rule which allows an undisclosed principal to be shielded from liability where a bare trustee or nominee enters into a contract under seal, such as a mortgage of real property which is deemed by the
Land Registration Reform Act\textsuperscript{1} to be a sealed contract. For this reason, it is critical that a beneficial owners’ agreement be included as part of the security package where an asset is held in trust by a nominee or trustee for third party beneficiaries.

Some of the key provisions of a beneficial owners’ agreement include the following:

**Confirmation of bare trust and authority and direction to charge asset**

- all beneficial owners and the nominee should be party to the agreement and confirm that: (a) the real property is held by the nominee as bare trustee for the beneficial owners and the nominee is required to transfer legal title to the beneficiaries, or as they may direct, at their request; and (b) the beneficial owners have the authority to charge the asset and irrevocably direct the nominee to do so;
- the declaration of trust and/or co-owners’ agreement should be attached as a schedule to the agreement and it should confirm, among other things: (a) the terms upon which the property is being held; and (b) who are the beneficiaries and whether all or a certain threshold of beneficiaries are required to authorize action on the part of the nominee;
- appropriate corporate/non-corporate authorizing resolutions should be obtained to ensure due authorization of all parties.

**Charge of beneficial interest and subordination of beneficial owners**

- the lender will also be a party to the agreement and beneficial owners should confirm in favour of the lender that: (a) both the legal and beneficial interest in the asset is charged as security in favour of the lender; (b) every interest that each beneficial owner has in the property (including any cross charges among the beneficial owners) is subordinate to the lender’s interest; and (c) to the extent not otherwise limited, the beneficial owners are personally liable for the debts and obligations secured by the assets.

**Authorization to register under the PPSA\textsuperscript{2} and required consents to changes in beneficial ownership**

- to the extent there is any personal property security related to the real property asset (for
example, rental income), the lender will want to register under the PPSA against not only the nominee but also the beneficial owners;

- the beneficial owners should covenant that there will be no change in the beneficial ownership of the property without the prior written consent of the lender.

**Authority to deal with nominee**

- the beneficial owners should confirm that the lender is entitled to deal with the security and the nominee without notice to the beneficial owners, as though the lender had no notice of the interest of the beneficial owners - while this provision is ideal in order to facilitate normal course dealings with the security, a lender would not necessarily want to rely upon this clause where there are significant changes to the obligations or security or in taking steps to enforce against the property.

**Further assurances and covenant to deliver financial statements**

- since the property will be an asset on the financial records of the beneficial owners, as opposed to the nominee, the beneficial owners should covenant to execute such further documents and provide any other deliveries required by the lender, including regular financial statements.

While the beneficial ownership agreement, or some other agreement establishing a contractual relationship with the beneficial owners, is important to personally bind the principal, it is not strictly speaking necessary for the purpose of charging the real property asset provided that the charge has been duly authorized. In fact, in some cases a lender may agree to limit the liability of the beneficial owners and restrict recourse to the asset alone.

In light of the agency relationship and the implications of the “sealed contract” rule, a lender must take care in the due diligence process to identify where a bare trust exists and ensure that covenants are obtained from the appropriate parties.

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1 Land Registration Reform Act, RSO 1990, c L.4, as amended
2 Personal Property Security Act, RSO 1990, c P.10, as amended [PPSA]
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