

Trustees hold'em? Charity Commission blasts unsecured lending by charitable trustees – even where it might end in profit.

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Introduction & Executive Summary



Photo by Shelagh Murphy: <https://www.pexels.com/photo/grayscale-photo-of-people-raising-their-hands-1666816/>

This week the Charity Commission has published the findings of a lengthy inquiry into the financial affairs of the Citygate Christian Outreach Centre.

Three now former trustees (collectively referred to as the "**Trustees**") caused over £948,450 to be lent to a property developer and associate of one of the trustees from 2018 to 2021. At no point did the Trustees take steps to obtain security for the monies loaned, nor did they seek professional independent advice on the ever-growing lending.

The loaned monies are now being repaid to the Charity in accordance with a settlement agreement, which provides for a full return of the loan value and some recovery of interest and costs - if the settlement agreement is complied with, the Charity will have financially benefited from the loans having been made.

To mark the seriousness of what they had done, the Commission removed two of the trustees from their position (automatically disqualifying them from acting as trustees or senior managers of any charity) and have disqualified a third trustee for a period of 2 years.

Key take-away 1: The Commission found that the following constituted serious misconduct and/or mismanagement in the administration of the charity over several years:

- A lack of due diligence;
- A failure to seek independent, professional advice about the proposal;
- Poor decision making throughout the loan period, including loaning a further £40,000 after having demanded (and not received) repayment;
- Inaction in recovering the loans which resulted in the charity's funds being exposed to prolonged undue risk.

Key take-away 2: The ends do not justify the means. Even if the lending results in a financial benefit to the Charity, it was the defective manner of governance which gave rise to the Commission's decision to exercise its statutory powers in respect of the Trustees.

The Commission investigated certain other potential instances of misconduct or mismanagement, but they were not made out, and are not discussed in this article.

Background

The Citygate Christian Outreach Centre was registered on 29 May 2005 with the primary objects of the advancement of the Christian religion; of education on the basis of Christian doctrine and principles; and for the relief of persons who are in conditions of need. The Charity maintains a church in Beckenham, it subsidises community enterprises, and serves its local community with hall hire facilities and community support programmes.



Photograph of Citygate Church, Beckenham (Doyle of London, creative commons)

Mr Julian Melfi (a Pastor at the Church in Beckenham, pictured above), and Mr Alan Samways (referred to by the Commission as the "**Former Trustees**") were trustees of the Charity at all material times, with a Mr Olawale Dada serving as trustee from December 2018 to March 2021 (referred to by the Commission as the "**Third Trustee**").

In 2018, one of the former trustees was approached by a property developer based in Dubai. The Inquiry noted that the property developer was an associate of one of the former trustees. The property developer proposed an investment opportunity to the former trustees, whereby the Charity would loan the property developer £100,000 with interest set at 10% per annum, in order to finance a real estate deal in Dubai. No paperwork was provided by the property developer to the Charity in respect of the Dubai deal.

On 6 February 2018, the former trustees signed the agreement, agreeing to lend up to £100,000 to the property developer. They did not consider securing the loan or applying a charge on any of the property developer's UK properties. They also failed to seek professional independent advice on the risks of the transaction.

Over the three years that followed, the Charity entered into further loan agreements, increasing its exposure to the property developer. At no point over that period did the Charity seek independent professional advice in respect of the increased lending to the property developer.

By March 2021, the Charity had made over 80 payments to the property developer, and loaned them excess of £900,000 - completely unsecured. An inquiry into the Charity's financial affairs was opened in March 2021 (the Charity having been placed on the Commission's double defaulter list). Remarking on this period, the former trustees *"informed the inquiry that they were not interested in whether the property was being developed and were only concerned in knowing that the loans and interest would be repaid."*

The Inquiry records the following in respect of the Trustees' conduct over this period:

"the former trustees failed to make any enquiries even at the most basic level to establish how the loans were being used, and saw no evidence that properties were being developed or any progress being made, and therefore no evidence that the loans would be repaid with interest. Nonetheless, the former trustees continued to sign loan agreements on behalf of the charity and to send charitable funds to the property developer."

The accounts which the Charity eventually submitted to the Commission were endorsed with qualified opinions from an independent auditor. These opinions highlighted the substantial potential risk of the extant unsecured lending on the Charity's viability, stating *"that the non-payment of loans identified may cast significant doubt on the Group's ability to continue as a going concern."*

This led to two immediate outcomes: the third trustee resigned from his post; and the Charity demanded repayment of its lending, with attendant interest.

Despite being £900,000 out of pocket at this point, the former trustees chose to provide a further £40,000 loan to the property developer. The Charity continued to make repeated requests to the property developer to repay the Loans through to August 2022. Promises of repayment were made over this time, but not kept.

In August 2022 the Inquiry, using its power under s84 Charities Act 2011 (“**CA 2011**”), directed the former trustees to take reasonable steps (including seeking independent professional advice) to recover the loans.

What happened with the loans?

Statutory demands were issued, and a settlement agreement has now been reached. The Charity has, as of the date of the Inquiry’s decision, recouped £500,000 under the settlement agreement - with payments to follow of the full balance of the loan, and some of the interest and costs which are due. The Inquiry does not give details of the settlement agreement, but it notes that *“if the property developer continues to adhere to the settlement agreement, the charity will not have suffered a financial loss.”* The “if” is, of course, highly operative. It remains to be seen what if any financial damage (or indeed benefit) the Charity will sustain as a result of the Loans.

Duties of Care

The Commission was highly critical of the Trustees’ conduct during the life of the Loans:

“Whilst the former and third trustee may have acted in good faith, the lack of due diligence and failure to seek advice about the property developer’s proposal, followed by poor decision making throughout the loan period, and inaction in recovering the loans resulted in charity funds being exposed to prolonged undue risk. This is serious misconduct and/or mismanagement in the administration of the charity over several years”.

The decision to loan a further £40,000 to the property developer while repayment demands remained unsatisfied comes under fire, the Inquiry noting that *“this further demonstrated to the inquiry the former trustee’s inadequate decision making and inability to grasp the seriousness of the auditor’s qualified opinions.”*

These comments should not come as a surprise. Notwithstanding that at the end of the day, the Trustees’ gamble might be said to have paid off, the gamble itself contravened a number of the established principles which govern charitable trusteeship.

Charity trustees are subject to a broad set of duties derived from diverse sources, including the governing instrument of the charity itself, the common law of charities, and the CA 2011.

By s17(5) CA 2011, charity trustees are required to have regard to guidance published by the Commission in pursuance of its public benefit objective when exercising powers/duties to which the guidance is relevant. Guidance CC3 is of particular relevance to this case, and it bears highlighting when evaluating the conduct of the Trustees.

Guidance CC3 paragraph 7 notes "you must act responsibly, reasonably and honestly. This is sometimes called **the duty of prudence**. Prudence is about exercising sound judgment. You and your co-trustees must:

- Make sure the charity's assets are only used to support or carry out its purposes
- Avoid exposing the charity's assets, beneficiaries or reputation to undue risk
- Not over-commit the charity
- Take special care when investing or borrowing

...

You and your co-trustees should put appropriate procedures and safeguards in place and take reasonable steps to ensure that these are followed. Otherwise you risk making the charity vulnerable to fraud or theft, or other kinds of abuse, and being in breach of your duty."

This is part of the duty to act with reasonable care and skill (which is both equitable and statutory – see Guidance CC3 paragraph 8, and the Trustee Act 2000).

An aspect of this duty is a duty to take advice when necessary - Guidance CC3 paragraph 8.2 notes "this is particularly important if the charity (or its property) may be at risk ... for example, when ...

- Investing charity funds
- Entering into novel, long-term, complex or high-value contracts."

The Inquiry repeatedly criticises the Trustees' failure to seek professional advice – which belies the particular emphasis which the Commission placed on this aspect of the Trustees' conduct. In its discussion of the issues which arise out of this case of relevance to the wider sector, the Commission stated that:

"it is difficult to see how trustees could discharge their legal duties without taking and properly considering independent professional advice as they would be exposing the charity and its property to significant risk by failing to do so."

Ultimately, the former trustees were removed from the office of charity trustee by an Order of the Commission under s79 CA 2011 in June 2023. The former trustees are thus automatically disqualified from acting as trustees of any charity. The Commission also saw fit to disqualify the third trustee from acting as a charity trustee for a period of 2 years (the third trustee having resigned his post as mentioned earlier).

The Commission identified as giving rise to grounds for the Inquiry to exercise its s79(4) CA 2011 powers, failures to:

- Act in the charity's best interests;

- Manage the charity's resources responsibly and avoid exposing the charity's assets to undue risk;
- Exercise appropriate decision-making;
- Take advice and be sufficiently informed;
- Act with reasonable care and skill.

Conclusions

The Inquiry's decision provides helpful lessons and take-aways for trustees navigating the financial management of their charities.

It is an illustration of a long-standing principle of law of fiduciary duties: the risks one might reasonably take with one's personal finances are unacceptable when taken by fiduciaries in respect of trust assets. In essence: a fiduciary's wager never pays off, even when it does.

In practice, prudent charity trustees might consider the following courses of action:

- **Think twice before any unsecured lending.** Unsecured lending always involves a risk. It may sound like a good idea at the time, but if everything goes wrong – and the borrower disappears or goes insolvent – will you be able to say with a straight face that you acted prudently? In the vast majority of cases, the answer is likely to be 'no'.
- Review the **nature and extent of any existing unsecured lending** which their charity has in place, and taking steps to limit exposure where possible.
- Review the processes which govern financial decision-making within the Charity – **is taking independent professional advice baked into those processes?**
- If you think something doesn't look right, don't bury your head in the sand – take independent professional advice as soon as possible. The Commission clearly criticises the **ongoing failure** by the Trustees to take independent professional advice in respect of recovering the loans that had already been made.