Investing in Australian Real Estate
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In the wake of last year’s significant international developments, foreign investors’ appetite for Australian real estate is showing no signs of abating.
Australia’s real estate market continues to boom. It is an active and transparent market, favoured for cross-border investment due to its high quality stock, strong economic conditions and stable governance.

Overseas investors are capitalising on the opportunities in Australia’s real estate market. At the same time, Australia’s superannuation funds and large institutions are rebalancing their portfolios towards direct investment in real estate, while both local and foreign buyers are driving strong demand for residential housing stock. This is creating intense competition for traditional prime office, retail and industrial assets, as well as investor-grade development sites, which is, in turn, giving rise to opportunities in related asset classes.

Australia has an open foreign investment policy, making it relatively easy for foreign investors to enter the Australian market, alongside a flexible market-driven economy which encourages new and expanding enterprises. However, the robust legal and regulatory framework which support and protect the Australian real estate market, can sometimes be difficult for foreign investors to efficiently navigate without appropriate advice.

Our aim in this Guide is to lead you through the main issues that you may need to consider as a foreign investor looking to invest in Australia’s real estate market, whether that investment is in office, retail or industrial space or student accommodation, apartments or housing stock.

The contents of this Guide are correct as at 1 February 2017.
LAND OWNERSHIP IN AUSTRALIA
Australia is a federation of six states and territories. Although each state and territory has its own land law, there is consistency across Australia as the ownership of most land in Australia operates under the Torrens title system. This system provides for registration of title to land in a central registry in the relevant state or territory.

Freehold title is the most common, and the most comprehensive, title to be obtained in Australia and it gives an owner of land the most rights. However, certain land can only be held under a lease from the Government (known as a Crown or a state Lease), particularly in the Australian Capital Territory and rural areas across the various states. Such leases are either in perpetuity or for a long term, and give the tenant many of the rights that a freeholder landowner would enjoy.

Due diligence

Land in Australia is generally sold on an ‘as is, where is’ basis, with the buyer being expected to satisfy itself as to the property prior to purchasing it. Vendor warranties are generally of a limited nature or not readily given. This means that you, as a purchaser, need to undertake due diligence enquiries in relation to a property before acquiring it. The extent of the due diligence you need to do is determined by the nature of the property, its location, your proposed use and development plans, your funding arrangements and your tolerance of risk.

The time required for your due diligence should be factored into your acquisition timetable. For most properties, due diligence will include physical, taxation and legal assessment and analysis.

Legal due diligence generally includes:

- conducting a title search at the land registry, to determine the owner and any registered encumbrances (e.g., easements, mortgages, restrictions on use and agreements with government bodies about works or the property’s use);
- applying for searches from various statutory authorities, to determine the government rates and taxes that apply, planning issues (e.g., permitted and prohibited uses and any restrictions on potential development), proposed resumptions and heritage issues;
- reviewing any tenancy documents to verify income and identify capital expenditure and tenure risks; and
- considering any planning or other approvals or licences required to hold, develop or operate the property.

You may engage other consultants to value, inspect or assess the property and its services and equipment, in order to identify future capital expenditure and the level of compliance with building codes and environmental legislation. Financial institutions lending money will often do their own due diligence as a precondition of funding.
PLANNING APPROVALS

Overview

Each Australian state and territory has its own planning law and system for the approval of the use and development of land. Depending upon the zone in which the land is located, different approval requirements will apply for the use of land, the development of buildings and works on that land and any subdivision of the land parcel.

Most states and territories have local council regions responsible for the administration of planning and development approvals under the local planning schemes or development plans and also state and local planning policies.

Most states and territories also have ‘fast-track’ processes where the state or territory Minister responsible for planning or the relevant state or territory department of planning can issue approval directly for more significant projects.

Zoning of different areas of land is set out in the planning scheme maps for each local council area. Zones in most states include residential, industrial and commercial, and public use zones. Each zone’s planning scheme usually has a purposes or objectives section, which sets out the expectations for that zone and helps guide decision-makers about the appropriate forms of development in that zone. For example, the Victorian Residential Growth Zone has as one of its purposes: ‘To provide housing at increased densities in buildings up to and including four storey buildings’. Each zone then sets out the types of uses that are permitted without the need for a planning approval, require a permit, or are prohibited.

Most planning schemes also have additional layers of control for certain areas within their council/city boundaries, for example, for the additional protection of heritage sites or precincts, native vegetation, or other environmentally sensitive areas of land.

Environmental approvals for matters such as impacts on protected flora and fauna, air emissions or waste produced by the project, or in relation to development on contaminated land are generally separately managed through state or territory environment protection agencies and departments responsible for environment and sustainability regimes. Depending upon the size of the project, the environmental and planning approval regimes can be combined to streamline the issuing of the approvals.

Options for structuring approvals

Depending on the nature of the site of interest and the appetite for risk, there are several options for structuring the way that approvals are managed in the purchase process.

Purchase fully approved project

Obviously this is the least risky approach; however, it is also the least flexible and likely to be more expensive as a premium will be added to the purchase price for the approval.

Due diligence enquiries should be carried out to confirm that:

- the approval is valid and has not expired (or can be extended);
- there are no other approvals required (such as heritage or flora and fauna, or contamination clean-up); or
- any conditions of the approvals are not too restrictive.
Generally, project approvals can be amended subject to an application process to the Authority which issued that approval. This can potentially allow for some changes to the conditions of the approval or to the plans in the event that changes are required or a new design is considered more viable. Amendments can potentially change parameters such as the height of a building; however, amendments cannot so significantly alter the approved development that it would be considered to be a ‘transformation’ of the originally approved project. If changes sought are a transformation, then a new approval process is required.

**Purchase made subject to obtaining approval for proposed project**

Any purchase that is subject to obtaining an approval for the proposed development should include terms that specify:

- which party is to apply for the approval;
- the agreed nature of the proposed use and development;
- that the approval must be issued on terms reasonably acceptable to the Purchaser; and
- that the approval must be obtained (and no longer subject to third party appeal) within a set time-frame.

Purchaser due diligence will be important to determine the likelihood of obtaining the desired approvals. This should include investigating all zoning restrictions, policy imperatives, flora and fauna and heritage constraints, and any contamination clean-up liabilities.

**Purchase of land without approval for proposed project**

Obviously this approach carries the greatest regulatory risk, but is also potentially a greater value proposition if lower value land can be rezoned for the desired purposes and an approval obtained for the proposed project.

Comprehensive purchaser due diligence will be very important to determine the likelihood of obtaining the desired rezoning or approval. This should include investigating all current zoning restrictions, planning policy imperatives, flora and fauna and heritage constraints, and any contamination clean-up liabilities.

**CONTAMINATION**

Although each Australian state and territory has its own laws relating to the contamination of land, generally the ‘polluter pays’ principle is applied, which means the person who caused the contamination is responsible for any required remediation. However, the various state and territory authorities responsible for the enforcement of environmental laws in Australia may also have recourse to the owner, occupier or mortgagee of land in certain circumstances (eg where the polluter no longer exists or cannot be found).

For industrial properties, or properties where contamination is suspected, a purchaser would usually commission an environmental consultant to prepare an environmental report as part of the due diligence for the acquisition or, at least, review available reports provided by a vendor. This information can then be used to consider appropriate allocation of liability going forward and any indemnities that may be required (including whether there is a need for any security in support of the indemnities).

The potential for ongoing liability for contamination may be relevant when deciding whether to proceed through an acquisition of shares or a direct transfer of the asset.
NATIVE TITLE

Native title in a nutshell:

- Australia’s indigenous inhabitants may hold native title rights over land and water.
- Native title not usually an issue in urban centres.
- Native title must be considered if you buy land in rural or remote areas.
- If native title has not been extinguished, you may need to make agreements with indigenous peoples.

Australia recognises that its indigenous inhabitants may continue to hold traditional rights and interests in relation to land and waters, and these are known as native title rights. Native title law operates in addition to cultural heritage protection laws.

A number of government actions have completely extinguished native title rights over land, and this is generally the case for all registered freehold land, and for most types of leasehold interest. In established urban centres, native title is not usually an issue for a land buyer. But in rural and remote parts of Australia, or for developments involving government land release, native title should be more closely examined. Because native title was not recognised in Australia until 1992, the nature and timing of land tenure interests are important in determining what, if any, additional steps need to be taken to ensure development on land is valid.

Generally, government grants of tenure that occurred before 1994 are ‘past acts’ and are valid. Past acts are divided into four categories. The different categories have different impacts on native title. Therefore it is important to know the nature of the underlying tenure before the applicability of native title can be determined. For example, ‘Category A’ past acts (such as a freehold grant) extinguish native title, whereas other categories may only extinguish native title ‘to the extent of any inconsistency’ or may merely suspend the operation of native title in respect of a particular grant.

‘Future acts’ are, broadly, government acts (such as the grant of freehold or leasehold interests) that occur after 1 January 1994 and which affect native title (by, for example, extinguishing native title entirely, or otherwise being inconsistent with its continued existence, enjoyment or exercise).

Where native title has not been extinguished, further investigations may be required and agreements with relevant indigenous peoples (or specific statutory processes) can allow land use and development to proceed.

Native title rights will generally apply to Crown or government land. However, separate Aboriginal and Torres Strait Islander cultural heritage protection requirements may apply to any land in Australia (irrespective of whether the land is privately or publically owned). Both regimes may require negotiation with indigenous peoples and therefore, a timeframe for engagement may need to be included in project development schedules.
HOLDING COSTS

Real estate owners in Australia incur annual rates and taxes, levied by State, Territory or local government authorities. The main types are:

- **council rates** – generally based on the capital improved value (value of land and buildings) or unimproved value (land only) of the property, the rates contribute towards the cost of running the council and community services (e.g., garbage collection and disposal, development, repair and maintenance of community centres, libraries, parks and gardens and local roads). Each council imposes a different rate for calculating the rates payable;

- **water rates** – used for the installation, repair and maintenance of water assets; and

- **land tax** – calculated by reference to the taxable value of a property (being the unimproved or site value of the land). The taxable value of all property of an owner within a State is aggregated to determine the rate of land tax payable. Certain jurisdictions have also recently introduced land tax surcharges for foreign persons – in Victoria, foreign persons will be subject to an additional surcharge of 1.5 per cent, and in NSW, foreign owners of residential property will pay an additional surcharge of 0.75 per cent.

The following table provides an example of the annual land tax payable in each state or territory based on a commercial property with a taxable value of $10 million.

<table>
<thead>
<tr>
<th>State</th>
<th>Annual Land Tax Payable on Property with Taxable Value of $10m²</th>
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<tbody>
<tr>
<td>NSW</td>
<td>$177,888</td>
</tr>
<tr>
<td>VIC</td>
<td>$182,475&lt;sup&gt;1&lt;/sup&gt;</td>
</tr>
<tr>
<td>QLD</td>
<td>$175,000</td>
</tr>
<tr>
<td>SA</td>
<td>$340,287.50</td>
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<tr>
<td>WA</td>
<td>$166,550</td>
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<tr>
<td>TAS</td>
<td>$146,587.50</td>
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<tr>
<td>NT</td>
<td>N/A&lt;sup&gt;2&lt;/sup&gt;</td>
</tr>
<tr>
<td>ACT</td>
<td>N/A&lt;sup&gt;3&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

Rates and taxes are generally paid by quarterly instalments and are usually passed on to a tenant through the outgoings provision in a lease; however, this may be precluded by legislation for some charges – for example, land tax in Victoria and Queensland is not able to be passed on to a retail tenant.

Water consumption is generally paid by the occupier of a property and charged separately.

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1. Rates applicable as at 1 January 2017, and with the assumption that a single-holding basis and no additional surcharges apply.
2. Northern Territory does not impose land tax.
3. Commercial properties in the ACT are not subject to land tax (since 1 July 2012).
4. $332,475 where the owner is a foreign person.
FOREIGN INVESTMENT REVIEW BOARD
The acquisition of Australian real estate by foreign persons is subject to approval requirements under the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (*FATA*). Applications are required to be made to the Foreign Investment Review Board (*FIRB*) for approval by the Australian Treasurer or a delegate.

**Framework**

Under the *FATA*, certain types of acquisitions of Australian real property assets by ‘foreign persons’ require approval.

A ‘foreign person’ is generally:

- an individual that is not ordinarily resident in Australia;
- a foreign government investor\(^1\);
- a corporation, trustee of a trust or limited partnership in which an individual not ordinarily resident in Australia, a foreign corporation or a foreign government, holds an interest of at least 20 per cent; or
- a corporation, trustee of a trust or limited partnership in which two or more individuals not ordinarily resident in Australia, or two or more foreign corporations or foreign governments, hold an aggregate interest of at least 40 per cent.

Where a proposed acquisition requires approval under the *FATA*, the acquisition cannot be made without prior approval. If the parties to a transaction wish to enter into documentation prior to approval being obtained, completion of the acquisition must be conditional on receipt of the approval.

Responsibility for making a decision on whether or not to approve a proposed acquisition rests with the Australian Treasurer. When making these decisions, the Treasurer is advised by the FIRB, a non-statutory body which examines foreign investment proposals and advises on the national interest implications. The Treasurer can prohibit a proposed acquisition covered by the *FATA* if it is considered to be contrary to the national interest.

**What is Australian land?**

The *FATA* divides ‘Australian land’ into four categories:

- ‘Agricultural land’: land which is used, or reasonably could be used for a primary production business (subject to certain exceptions, including land used for a mining operation).
- ‘Mining or production tenement’: a right to recover minerals, oil or gas from Australia or the seabed or subsoil of the offshore area (excluding exploration permits).
- ‘Residential land’: land containing at least one dwelling, or vacant land on which less than 10 dwellings could be built, not including land which is used wholly or exclusively for a primary production business or on which the only dwellings are commercial residential premises (such as a hotel, boarding house or caravan park).
- ‘Commercial land’: all other land in Australia.

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\(^1\) A foreign government investor includes a foreign government and any company, trust or limited partnership in which one or more foreign government entities from the same country hold an aggregate interest of at least 20 per cent, or in which any two or more foreign government entities from any countries hold an aggregate interest of at least 40 per cent.
Types of interests in Australian land

Investors should be aware that the FIRB requirements not only apply to outright acquisitions of freehold rights, but also to the entry into a lease (as lessee) or licence (as licensee) giving rights to occupy land for an unexpired term of at least 5 years, as well as acquisitions of shares in land-rich entities (including companies and trusts where interests in Australian land represent more than 50% of the corporation’s or trust’s assets by value).

Whether or not approval is required for a particular acquisition depends on various factors including the type of land, the value of the acquisition, the type of interest to be taken and the nature of the acquirer.

The table below outlines the circumstances in which a foreign person who is not a foreign government investor requires FIRB approval to acquire freehold title to Australian land from a person other than an Australian government.2

A foreign government investor is subject to more stringent requirements than other foreign persons and will generally require FIRB approval for any acquisition of an interest in Australian land, irrespective of value.3

<table>
<thead>
<tr>
<th>Type of Australian land</th>
<th>Approval required</th>
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</table>
| Agricultural land                    | Yes, if the total value of the interests in any Australian agricultural land held by the foreign person and their associates exceeds $15 million, subject to the following qualifications:  
  » if the foreign person is a US, Chile or New Zealand entity, FIRB approval is only required if the value of the land exceeds $1,094 million; and  
  » if the foreign person is a Singapore or Thailand entity, FIRB approval is only required if the value of the land exceeds $50 million and is wholly and exclusively used for a primary production business.  
  In addition, foreign persons are required to notify the Australian Taxation Office Register of certain types of interests they hold in Australian agricultural land (including freehold interests). |
| Mining or production tenement        | Yes, regardless of value.3                                                                                                                        |
| Residential land                     | Yes, regardless of value.                                                                                                                        |
| Established dwellings                | Yes, regardless of value. Owners of new residential developments may apply for a new dwelling exemption certificate which enables foreign persons to acquire new dwellings in the development without the need to obtain separate FIRB approval. Such exemption certificates are of ten granted to residential property developers. Yes, regardless of value. Approvals, if granted, will often be subject to conditions such as a requirement to build within a certain timeframe and to increase the housing stock. |
| New dwelling                         | Yes, regardless of value.                                                                                                                        |
| For redevelopment of established dwellings | Yes, regardless of value. Approvals, if granted, will often be subject to conditions such as a requirement to build within a certain timeframe and to increase the housing stock. |
| Commercial land                      | Yes, regardless of value.                                                                                                                        |
| Vacant commercial land               | Yes, regardless of value.                                                                                                                        |
| Non-sensitive developed land         | Yes, if the value of the land exceeds $252 million.3                                                                                             |
| Sensitive developed land (eg defence, telecommunications, nuclear, airport land) | Yes, if the value of the land exceeds $55 million.3                                                                                             |

2 Acquisitions by foreign persons (who are not foreign government investors) of Australian land from the Australian Commonwealth Government, or from a State or Territory government are exempt from the FIRB approval rules, except where the land is or includes public infrastructure or a nuclear facility.

3 If the foreign person is a US, Chile or New Zealand entity, FIRB approval is only required if the value of the land exceeds $1,094 million.
FIRB application and fees
FIRB applications are submitted online through the FIRB website (with the exception of applications to acquire residential land which are submitted via the Australian Taxation Office website). It is customary to attach a detailed covering letter to the online application, which is commonly known as the ‘application letter’.

Foreign persons must pay a fee for each FIRB application made. The fee payable depends on the type of land acquired.

For residential and agricultural land, the fee payable will depend on the value of the property being acquired. For mining or production tenements and commercial land there are set fees depending on the nature of the land and the type of investor. For agricultural land, mining or production tenements, fees range from $5,000 to $101,500. For residential land, the fee depends on the value of the property being acquired, and starts at $5,000.

Approval process
Once a FIRB application has been lodged (and FIRB confirms that the application fee has been paid) the Treasurer has 30 days in which to make a decision, and a further 10 days in which to notify the applicant. FIRB may extend this period by up to a further 90 days (usually for larger or more complex cases).

The Treasurer has the power to determine on a case-by-case basis whether a proposed transaction will be contrary to the ‘national interest’. The concept of ‘national interest’ is not defined in the legislation, but the Australian Government’s published foreign investment policy states that the Government typically considers the following factors when assessing foreign investment proposals: national security; competition; other Australian government policies (including tax); impact on the economy and the community as well as employees; and character of the investor.

For investors contemplating frequent acquisitions, pre-approval (known as an exemption certificate) can be sought for a program of land acquisitions on a periodic (usually annual) basis.
4

ISSUES TO CONSIDER WHEN STRUCTURING YOUR DEAL
How to acquire real estate in Australia

- a direct transfer from one entity to another
- an acquisition of the shares or units held by the owner
- a call option or a put and call option agreement
- a long-term lease

Acquiring real estate

There are various ways to acquire real estate in Australia:

- a direct transfer from one entity to another;
- an acquisition of the shares or units held by the owner;
- a call option or put and call option agreement; or
- a long-term lease.

There are legal, regulatory and tax consequences for each method, which will influence what is the most appropriate method for you to choose. For example, the use of a Managed Investment Trust, or of leases and subleases of a property, may have advantages for flow through or withholding tax exemptions (see below in relation to tax issues).

Forms of direct and indirect investment

Common forms of Australian real estate ownership

Australian laws recognise various forms of ownership of real estate. Some of the more common forms for commercial real estate include:

- **TRUST**: a trustee holds the real estate on trust for the benefit of one or more beneficiaries.
- **COMPANY**: a company may own real estate in its own right and distribute profits to shareholders (if, in particular circumstances a trust is the preferred holding vehicle, a company may also be used as a trustee entity).
- **TENANTS IN COMMON**: a tenancy in common arises where there are two or more owners, and each owner owns a share of the property. That share can be dealt with separately. This is a common form of co-ownership for large office buildings and shopping centres supported by an agreement between the co-owners.
We can provide guidance on:

- ways in which investors gain ‘direct’ exposure to real estate, focusing on both trust holding structures (particularly tax-efficient trust holding structures known as a ‘Managed Investment Trust’) and company holding structures; and
- the different types of collective investment vehicles through which investors gain an ‘indirect’ exposure to a portfolio of real estate assets.

You must consider the Australian taxation consequences before you undertake any investment. This should be the first step you undertake in the process. The optimal investment structure from a tax perspective will differ for each investor, depending on the investor’s identity and location, the property’s type and the investment’s nature. We provide some information on the major relevant Australian tax considerations in this Guide.

‘Direct’ investment in Australian real estate

When considering how to invest ‘directly’ into Australian real estate — that is, for the investor to gain an undiluted exposure to a single real estate asset — investors tend to choose between two legal structures — an investment in the real estate via an Australian unit trust or an investment via a corporate vehicle.

Trust structures (including MIT structures)

A common means by which foreign investors in particular will seek to hold their investment in commercial real estate in Australia is by establishing or investing in a unit trust structure.

Trusts in general

Under a trust structure, a trustee company (which, depending on the nature of the trust, may be a subsidiary company of the investor or an independent professional trustee) holds the real estate on trust for the benefit of the foreign investor under the terms of a trust deed.

The benefit of a trust structure is that it allows for the distribution of income to investors in a tax efficient manner (and concessional tax benefits may be available for certain types of trusts) — that is, a trust is a ‘transparent’ vehicle for Australian tax purposes as no tax is paid (in ordinary circumstances) by the trust itself.

However, depending on the nature and number of investors in the structure, the trust structure can sometimes be more complicated and expensive to establish and maintain than a company structure (particularly for investors from jurisdictions that aren’t familiar with trust structures).

Managed Investment Trusts

Generous withholding tax concessions are available to foreign investors participating in a unit trust structure that qualifies as a Managed Investment Trust (MIT). A key benefit is that it generally entitles foreign investors to a concessional withholding tax rate of 15 per cent (rather than the standard 30 per cent rate that would otherwise apply) for eligible distributions made from the MIT.

In broad terms, a MIT is simply a standard Australian unit trust that meets certain requirements — the key ones being that:
1. Either the trustee of the trust must be an Australian resident, or otherwise central management and control of the trust must be in Australia.

2. The trust must, subject to a limited exception, be a ‘managed investment scheme’, as defined in the Corporations Act. A trust would generally be eligible to be a managed investment scheme provided that it has at least two members and those members do not have day-to-day control over the scheme’s operation. Such a scheme will generally be established as a unit trust.

3. The trust must not carry on a trading business or control a trading business. In general terms, this means that its business must consist only of investing in land primarily for the purpose of deriving rent, or of investing in debt securities, shares in a company, units in a unit trust, derivatives or life assurance policies. The trust must also not have the ability to control, directly or indirectly, the affairs or operations of an entity that carries on a trading business.

4. A substantial portion of the investment management activities carried out in relation to the trust’s Australian assets must be carried out in Australia.

5. The trust must generally be operated by an entity holding an appropriate Australian Financial Services Licence.

6. The trust must satisfy certain requirements aimed at ensuring the trust is ‘widely held’ and not ‘closely held’.

Note: The taxation regime applicable to MITs is currently under review and it is possible that any resulting reforms may affect certain aspects of the regime.

Company structures

An alternative (although, given the tax considerations, less common) means by which foreign investors can invest ‘directly’ into Australian real estate is by establishing a company to own the real estate in its own right. There are three options:

- establishing a new company,
- registering a non-Australian company as a foreign company that operates in Australia, or
- acquiring an existing company.
Foreign investors seeking to establish a new Australian company need to register the company with ASIC, Australia’s corporate regulator. Alternatively, foreign entities may wish to carry on business in Australia as a foreign company registered under Part 5B.2 of the Corporations Act. As with Australian companies, foreign companies must be registered with ASIC.

‘Indirect’ investment in Australian real estate

As an alternative to a ‘direct’ investment into real estate, many investors seek to gain an exposure to a portfolio of Australian real estate ‘indirectly’ by investing in a pooled investment structure or fund of some sort. The following sections explain what that option involves and some of the key differences between different fund types commonly used in Australia.

What is a managed fund?

A popular method by which retail and wholesale investors can gain indirect exposure to Australian real estate in a pooled vehicle alongside other investors is by investing into a managed investment scheme or ‘managed fund’.

A managed fund refers to an investment that pools together different investor’s money to invest in a specified range of investments. The investment decisions are made on behalf of the investors by a trustee, responsible entity (in the case of a registered fund) or fund manager and are made in line with the fund’s stated investment strategy.

When you invest in a managed fund, you are typically allocated a number of ‘units’ (rather than shares) where the number of units you receive depends upon the amount of your monetary investment. Each unit has a dollar value that is known as the ‘unit price’. While the number of units you own doesn’t change, their value will change in line with the market value of the underlying investments.

Interests in managed funds will generally be offered with a Product Disclosure Statement (in the case of a registered fund open to retail investors) or Information Memorandum, which (among other things) will typically state the investment objective, benefits and fees and costs of the fund. The disclosure document also typically details the types of investments which the fund will hold (and, for existing funds, details of any investments currently held by the fund and the previous performance of the fund), how the investments will be managed, the types of risk investors can expect and the fees payable to the fund manager.
Different types of managed funds

Wholesale vs retail funds

As the name suggests, wholesale funds are open for investments from ‘wholesale’ or professional investors only (and will often have minimum investment amounts than retail funds). Retail funds are designed to cater for individual ‘mum and dad’ investors and usually have a relatively small minimum investment amount. Retail funds are typically subject to higher regulation under the Corporations Act 2001 (Cth).

Under the Corporations Act, an investor is considered a ‘wholesale investor’ if it is any of the following:

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<tr>
<td>i</td>
<td>a person or entity that invests A$500,000 or more.</td>
</tr>
<tr>
<td>ii</td>
<td>a person or entity that can demonstrate, by way of an accountant’s certificate, that the person has net assets of at least A$2.5 million or a gross income for each of the last two financial years of at least A$250,000.</td>
</tr>
<tr>
<td>iii</td>
<td>a person or entity where their investment in a financial product or financial service is provided for use in connection with a business that is not a ‘small business’ (a business employing less than 20 people (or, if the business is or includes the manufacture of goods, 100 people)).</td>
</tr>
<tr>
<td>iv</td>
<td>a financial services licensee.</td>
</tr>
<tr>
<td>v</td>
<td>an entity regulated by Australian Prudential Regulation Authority, other than a trustee of a superannuation fund, an approved deposit fund, a pooled superannuation trust or a public sector superannuation scheme.</td>
</tr>
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<td>vi</td>
<td>a registered body under the Financial Corporations Act 1974 (Cth).</td>
</tr>
<tr>
<td>vii</td>
<td>a trustee of a superannuation fund, an approved deposit fund, a pooled superannuation trust, or a public sector superannuation scheme within the meaning of the Superannuation Industry (Supervision) Act 1993 (Cth) and the fund, trust or scheme has net assets of at least A$10 million.</td>
</tr>
<tr>
<td>viii</td>
<td>a listed entity, or a related body corporate of a listed entity.</td>
</tr>
<tr>
<td>ix</td>
<td>an exempt public authority.</td>
</tr>
<tr>
<td>x</td>
<td>an investment company, being a body corporate or an unincorporated body that carries on a business of investment in financial products, interests in land or other investments, and for those purposes invests funds received following an offer or invitation to the public where the terms of the offer provided for the funds subscribed to be invested for those purposes.</td>
</tr>
<tr>
<td>xi</td>
<td>a foreign entity that, if established or incorporated in Australia, would be covered by any of paragraphs (iv) – (x) above.</td>
</tr>
</tbody>
</table>

Registered vs unregistered funds

Certain managed fund products are required to be registered with ASIC – these funds are known as ‘registered managed investment schemes’ (and referred to elsewhere in this document as registered funds).

In broad terms, a fund will need to be registered when the interests in the fund are offered to retail investors (though some wholesale funds are also registered).

The registration of a fund as a registered scheme has a number of practical and legal benefits for investors as a result of the regulation imposed on all registered schemes under Chapter 5C of the Corporations Act.

In particular, Chapter 5C regulates certain aspects of the operation of the Managed Investment Scheme,
including:

- the responsibilities and powers of the ‘Responsible Entity’ (which has the dual role of trustee and manager of the scheme, though it may outsource some of its functions);
- the retirement or replacement of the Responsible Entity (both voluntary and at the behest of investors);
- some content requirements of the Constitution of the scheme;
- the requirement for the Responsible Entity to establish a ‘compliance plan’ and (in some circumstances) a ‘compliance committee’ in relation to the scheme;
- the circumstances in which investors may withdraw from the scheme while the scheme is ‘not liquid’ (ie where liquid assets of the scheme account for less than 80 per cent of value of the scheme’s property); and
- to a limited degree, the procedure for the winding-up of the scheme.

You can tell whether the fund you are investing in is a registered managed investment scheme by searching the ASIC register for the scheme’s Australian Registered Scheme Number (ARSN).

**Listed vs unlisted funds**

Managed funds can be either listed or unlisted. Units in listed funds are traded on the Australian Securities Exchange (ASX), and their value is determined by supply and demand, whereas units in an unlisted fund are typically acquired by making an application to the fund manager for the subscription of new units.

One key advantage of investing in a listed property fund is that it may be more ‘liquid’ (ie investors can more readily convert their interest in the fund into cash) than an unlisted fund, as investors can simply instruct their broker to sell their holding on the ASX. In an unlisted fund, investors will typically have to comply with a pre-emptive rights regime if they wish to sell their units (which can take some time and be more complicated than selling on market), or request the fund manager to redeem their units (which, depending on the nature of the fund and its investments, is a request that may not be granted and, if granted, may take a considerable period of time).

**Comparison of investment options**

**Advantages of managed funds**

Investors may choose to invest into a managed fund (as opposed to making a direct investment in real estate) for a number of reasons. Some of the key benefits of investing in a managed funds include:

**Simple and quick**: Investing in a managed fund can be a relatively simple and quick process, depending on your understanding of the industry and familiarity with the terms of such funds. Experienced investors will simply need to select a suitable fund (or fund manager) and ensure that the terms of the investment are appropriate to suit the investor’s commercial needs.

**Access to existing portfolio and experienced management**: Investing in a managed fund provides investors with access to a range of investments which (as a single investor) may not ordinarily be available or affordable. Investors also gain the benefit of a professional fund manager’s expertise and experience, who may have access to information and investment opportunities not readily available to individuals.
**Diversification**: As a managed fund involves the pooling of money with other investors, the range of investments that can be purchased is often much wider than the range of investments that may otherwise be purchased directly by a single investor. The greater level of diversification means that investors are less exposed to the performance fluctuations of individual assets.

**Regular income**: Managed funds typically offer monthly, quarterly or six-monthly income distributions to investors, providing a regular source of income for investors. Distributions may be paid in cash or reinvested back into the fund.

**Disincentives of managed funds**

However, there are also a number of disincentives to investing into a managed fund rather than investing directly. In particular:

- **Fees**: Investors investing in a fund product will be charged fees (ie to compensate the fund manager for performing its role). Real estate funds in Australia can sometimes charge higher fees than other investment types (such as exchange traded funds) and investors will have less control over the expenses incurred in acquiring and managing the real estate assets.

- **Liquidity**: An investor’s ability to exit its investment in an unlisted managed fund may be limited because of the illiquid nature of the underlying investments. In particular, investors in an unlisted property fund may only be able to exit their investment by way of a transfer of units to existing or new investors or redemption at certain pre-identified time periods (eg every 7 or 10 years).

- **No day-to-day involvement in key decisions**: Investors must rely on the skills of the fund manager, who will have complete discretion in the fund’s management and investment, and investors will have little to no ability to influence the fund’s day-to-day operations. However, depending on the size of investment, investors may have the ability to negotiate certain amendments to the fund documents. In any event, this restriction exists also in the case of a direct investment through an asset-specific MIT.

- **Understanding terms of investment**: The managed fund’s terms of investment may be complex and legal due diligence of the investment documents will assist investors in understanding the fund’s operation and any restrictions imposed on investors.
TAX ISSUES TO CONSIDER
Foreign entities intending to invest in Australian real estate need to consider the Australian taxation consequences of such an investment. In considering what structure to adopt, different considerations may apply for each investor and each investment. Consequently, the optimal structure may differ for each investor depending on the particular circumstances. Australian tax considerations, as well as tax considerations in the foreign investor’s country of residence, may be relevant in determining how the investment should be funded and structured.

If a property investment or business is to have both Australian tax-resident and non-resident investors or hold multiple properties, careful planning is required to maximise benefits for all involved. Depending on the circumstances, structures involving multiple tiers and different types of entities may allow investors to take advantage of their particular tax attributes, offset income and profits derived from one property with losses incurred by another, increase the flexibility of income distribution and enhance asset protection.

Set out below are some of the key Australian tax issues foreign investors should consider in contemplating an investment into Australian real estate. Readers should note that Australian tax law undergoes amendment from time to time.

**Income tax and capital gains tax**

Profits derived from the sale of Australian property are generally taxable to both residents and non-residents. For the purposes of the Australian tax system, property investors broadly fall into two categories:

- investors who acquire, build or develop property with a view to holding it long-term to derive rent, but who may later sell the property ([Passive Investors](#)); and
- investors who acquire, build or develop property with a view to profiting from its sale ([Active Investors](#)).

The category into which a particular investor falls is generally a question of fact which depends on the particular circumstances. Relevant factors to take into account include the repetition, regularity, sophistication and scale of activities, the purposes for which they are carried out and the amount of capital invested.

Active Investors are generally taken to hold their property on ‘revenue account’, with profits derived from the sale of their property being taxable under Australia’s broader income tax regime. On the other hand, Passive Investors are generally taken to hold their property on ‘capital account’, with profits derived from the sale of their property being taxable under Australia’s Capital Gains Tax ([CGT](#)) regime.

**Non-resident Passive Investors and Active Investors**

For tax purposes, both non-resident Passive Investors and Active Investors generally prefer to invest in Australian property through a managed investment trust.

If a non-resident Passive Investor or Active Investor invests through a trust (e.g. a unit trust), profits derived by the trust and distributed to unit-holders are generally taxed at rates applicable to the particular unit-holder. For example, non-resident companies would be taxed at 30 per cent, but non-resident individuals may be taxed at up to 45 per cent (the current top marginal tax rate for individuals). Any income not distributed by the trust in an income year is generally taxed to the trust at the top marginal tax rate for individuals (i.e. 45 per cent plus certain levies if applicable).
Resident Passive Investors

Australian resident Passive Investors will generally prefer to invest through a trust structure rather than a company. This is because Australian tax residents who are individuals or trusts and are Passive Investors (who are taxed under the CGT rules) may be eligible to claim a ‘discount’ such that only 50 per cent of the profits from the sale of land would be taxable, if the land has been held for at least 12 months. Importantly, this discount is not available to non-residents (on property acquired after 8 May 2012) and companies.

Diversified investments

If a property investment or business is to have both Australian tax-resident and non-resident investors or hold multiple properties, careful planning is required to maximise benefits for all involved. Depending on the circumstances, structures involving multiple tiers and different types of entities may allow investors to take advantage of their particular tax attributes, offset income and profits derived from one property with losses incurred by another, increase the flexibility of income distribution and enhance asset protection.

Managed Investment Trusts

Non-resident Passive Investors may be subject to Australian concessional withholding tax at a rate of 15 per cent (down from the standard 30 per cent that would ordinarily apply) on income and profits from property investments by establishing a new (or investing in an existing) Managed Investment Trust (MIT).

In order to qualify for the concessional withholding tax rate, an investor must be a tax resident in a country with which Australia has effective exchange of information arrangements in respect of taxation matters. The investor’s address, or place for payment, must be outside Australia and the payment cannot be connected with a business carried on by the investor through an Australian permanent establishment.

The concessional withholding tax rate does not apply to all distributions by a MIT. Typically, the 15 per cent withholding tax for MITs will only apply to distributions of (a) rental income; (b) capital gains from the disposal of Australia real estate; and (c) gains from the disposal of debt or equity securities where the MIT has elected for its assets to be taxed on capital account. Income of a MIT must be distributed within three months after the

Refer to the structuring section of this Guide for a summary of the requirements that must generally be satisfied in order for a trust to qualify as a MIT.

The taxation regime applicable to MITs is currently under review and it is possible that any resulting reforms may affect certain aspects of the regime.

In addition to being taxed on profits from the direct sale of Australian property, non-residents (both Passive Investors and Active Investors) are also taxed on profits derived from the disposal of certain ‘non-portfolio’ (ie 10% or greater) interests in entities the assets of which, directly or indirectly, consist principally of real estate in Australia. This liability can arise where one non-resident entity disposes of its interest in another non-resident entity if the underlying assets of that other entity directly or indirectly consist principally of real estate in Australia.

The Australian Government has recently introduced a non-final withholding tax on the sale of Australian real property by foreign residents on or after 1 July 2016. This includes direct and certain indirect interests in Australian real property. Under the regime, unless the vendor provides confirmation that it is an Australian resident, a purchaser is required to withhold from the foreign vendor and remit to the Australian taxation authority 10 per cent of the purchase price (unless one of the exceptions – for example, that the market value
of the real property is less than $2 million, or the transaction is on an approved stock exchange – applies). As a non-final withholding tax, the foreign resident can then lodge an Australian tax return in order to obtain a refund of any amount withheld in excess of the actual tax due in respect of the sale (or pay any shortfall).

**Funding the investment and Thin Capitalisation**

An investment in Australian real estate may be funded by debt, equity or a combination of the two.

Where an Australian resident entity that is controlled by non-residents borrows to finance its activities, a deduction is generally allowed for Australian income tax purposes for interest incurred in respect of the borrowing.

However, the amount of interest that is deductible may be limited under Australia’s ‘thin capitalisation’ rules. Under those rules, broadly, if the amount of a company’s debt exceeds 60 per cent of the asset value for thin capitalisation purposes, interest deductions may be denied in respect of the excess debt. In some circumstances, it may be possible to have a level of gearing higher than 60 per cent if an exemption applies or it can be demonstrated that the amount of debt represents an arm’s length level of debt.

**Australian Interest Withholding Tax (IWHT)**

If an Australian tax resident entity borrows money from overseas to fund its operations or investments, interest paid to the overseas lender will generally be subject to Australian IWHT.

Although Australian IWHT is a tax on the lender (rather than the borrowing property investor), it is the borrower’s obligation to withhold the correct amount of tax and remit it to the Australian taxation authority. Lenders may pass the cost of the IWHT onto the borrower. Careful consideration needs to be given to whether any exemptions from Australian IWHT may apply to a borrowing arrangement and, if not, the applicable rate of IWHT.

Exemptions from Australian IWHT may be available under Australia’s general tax law, as well as under a Double Tax Treaty between Australia and the country in which the lender is resident. For example, certain ‘syndicated loans’ and interest payments to ‘financial institutions’ may be exempt.

To the extent an exemption does not apply, Australian IWHT equals 10 per cent of the gross amount of the interest paid.

**Goods and services tax (GST)**

Australia has a GST regime that is broadly similar to many value-added tax (or VAT) and GST regimes in other jurisdictions. The statutory liability for paying GST to the Australian taxation authority is on the vendor.

However, the vendor generally passes this cost on to the purchaser as part of the purchase price.

The GST rules that apply to real estate transactions are complex, with different rules and exemptions applying to different types of real estate and transactions. For example, whether or not GST applies may depend on whether the land is vacant or built up, whether the land is used or intended to be used for farming purposes or whether the premises are new, residential or commercial.

Broadly speaking, the sale of new residential premises, vacant land, commercial residential premises (e.g., a hotel) and commercial premises (e.g., an office building or shop) are generally subject to GST. On the other hand, the sale of existing residential premises and certain transactions involving farm land may not be subject to GST. Further, the sale of real property will not give rise to GST where it is sold as part of a business as a going concern. Generally, the sale of leased commercial real estate qualifies for the going concern exemption.
In general, GST is levied at a rate of 10 per cent of the price for the transaction. However, in some limited circumstances, the ‘margin scheme’ concession may be used, in which case, the amount of GST payable would broadly be the difference between the sale price and the price the seller originally paid to acquire the property. The margin scheme is more commonly applicable to new property developments.

GST is generally also chargeable on a supply of property by way of lease, other than a lease of residential premises that are not commercial residential premises.

An investor may be required to register for GST in Australia.

**Duty**

Duty (also known as stamp duty) is payable by a purchaser on a transfer of land (with some exemptions and concessions) with the dutiable value generally calculated on the greater of: (a) the market value of the property; and (b) the GST-inclusive consideration (the price paid).

Each Australian state and territory administers its own duty system, with varying rates, exemptions, concessions and timing for payment. The location of the property will determine the applicable regime. The following table sets out the maximum rate of duty for a transfer of real estate in each state or territory.

<table>
<thead>
<tr>
<th>NSW</th>
<th>VIC</th>
<th>QLD</th>
<th>SA</th>
<th>WA</th>
<th>TAS</th>
<th>NT</th>
<th>ACT</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.5%</td>
<td>5.5%</td>
<td>5.75%</td>
<td>5.5%</td>
<td>5.15%</td>
<td>4.5%</td>
<td>5.45%</td>
<td>5.09%</td>
</tr>
</tbody>
</table>

In addition to imposing duty on direct acquisitions of land, each state and territory also imposes duty on the acquisition of interests in companies and trusts which hold Australian land – this is generally known as ‘landholder duty’. The landholder duty rules, again, vary between the different states and territories with the applicable regime depending on the location of the property.

Generally, the rules are triggered by the acquisition of a relevant ‘interest’ in a landholder. While shares in a company or units in a unit trust will usually constitute an interest, in some jurisdictions an interest may also be acquired through other means such as acquiring an ‘economic entitlement’ in a landholder or acquiring ‘control’ of a landholder. Generally, landholder duty is triggered when a person acquires a ‘relevant interest’ in a ‘landholder’.

If the landholder is a private (ie unlisted) entity, duty is generally triggered by the acquisition of a 50 per cent or greater interest or, where a 50 per cent or greater interest is already held, an increase in that interest. Where the landholder is a listed entity, duty is typically not triggered unless there is an acquisition of at least a 90 per cent interest. Detailed aggregation rules apply to determine when a person has acquired a relevant interest in an entity, such that interests acquired by ‘associated persons’ or other persons in ‘associated transactions’ may be aggregated.

The entity being acquired will be a ‘landholder’ if it has landholdings in the relevant state or territory with a value equal to or exceeding the applicable threshold value. The applicable threshold values are stated in the table below.

<table>
<thead>
<tr>
<th>Landholder Duty: Threshold land values</th>
</tr>
</thead>
<tbody>
<tr>
<td>NSW</td>
</tr>
<tr>
<td>$2,000,000</td>
</tr>
</tbody>
</table>

5 Premium rate of 7 per cent may apply for residential land.
6 The threshold for private trusts in Victoria is 20 per cent. The acquisition of any interest in an unlisted trust that holds property in Queensland or South Australia could trigger duty.
Complex tracing rules also apply to determine the landholdings of an entity. These tracing rules extend to entities incorporated outside Australia, with the result being that a foreign entity may be regarded as a landholder for Australian duty purposes by virtue of landholdings in Australia that are held through subsidiaries (or other entities in which the foreign entity has an interest).

Each jurisdiction defines ‘land’ differently. The definition of land generally includes traditional interests in land such as freehold and leasehold interests, but may be defined more broadly to include items that are ‘fixed to land’ even if those items are owned separately from the land.

Broadly speaking, duty is charged on the amount calculated by multiplying the value of the landholder’s land holdings in the relevant state or territory by the percentage interest acquired in the landholder. Some states also impose duty on the value of goods held by the entity (in addition to its land). The rates of landholder duty are generally the same as those that apply to direct acquisitions of property (varying from 4.5 per cent to 5.75 per cent, depending on the state or territory).

The person statutorily liable for paying landholder duty may include the acquirer, the acquirer’s associated persons and the target landholder entity.

**Stamp duty surcharge on foreign buyers of residential property**

NSW, QLD and Victoria impose a stamp duty surcharge on acquisitions of residential property by foreign buyers. This surcharge is imposed on acquisitions of both direct or indirect interests in residential property. The rate of the surcharge imposed in each jurisdiction is as follows:

- **NSW**: 4%
- **QLD**: 3%
- **Victoria**: 7%
ISSUES TO CONSIDER WHEN FINANCING YOUR DEAL
Some of the key questions to consider before seeking finance to acquire or develop property in Australia include:

- What type of investment/ownership structure should be used?
- What type of finance should be sought and when?
- What type of security will need to be provided?
- What criteria do lenders need to have satisfied with respect to presale contracts and lease agreements?
- What common ongoing reporting and monitoring obligations are included in finance documents?

Allens can provide investor and deal-specific advice for these areas. You need this advice early in the decision-making process to ensure that any possible legal or regulatory hurdles to your investment are identified and dealt with in the deal terms and timetable.

**Sources of finance and key features**

There are many ways that an investor can raise finance to acquire property or undertake a property development. Set out below is an overview of the different sources of funding: senior debt, mezzanine debt, debt capital markets and equity.

In determining an appropriate capital structure for the transaction, the following issues should be considered:

- What is the most appropriate source of finance for the acquisition or development?
- When should different sources of finance be sought?
- What type of return is the investor seeking?
- What risks is the investor seeking to mitigate?

The interaction between different tiers of debt is also important and a number of senior lenders in the market are uncomfortable with permitting capital structures that require inter-creditor arrangements. Accordingly, it is important to settle the capital structure early on.
Senior debt

Financial institutions can be selective when considering whether or not to provide debt to fund the acquisition of a property or development. This decision-making process is driven by a number of factors, including, at a macro-level, the lender’s internal requirements to manage the risk exposure to specific market sectors and tighter regulatory capital controls being imposed on banks.

Accordingly, it is important for investors to be aware of the issues that financial institutions will consider in assessing a potential transaction and the opportunities available to investors to minimise the impact of these risks before seeking finance.

Financial institutions are primarily looking to provide senior debt funding to support acquisitions that:

- have a stable income stream with long-term quality anchor tenants; and
- are located in areas where valuations are stable or growing.

On the development side, financial institutions are primarily looking to fund developments of established projects that:

- have the necessary planning and zoning approvals;
- are well advanced in negotiations with an established builder and project team; and
- have a source of development revenue in place in the form of presale contracts or agreements to lease.

Mezzanine debt

The term ‘mezzanine’ is used to describe debt that is secured but subordinated to senior debt. What this means is that the financial institution(s) providing the senior debt will have the right to:

- be repaid before the mezzanine lender; and
- enforce the security documents (without the involvement of the mezzanine lender).

Where the borrower of the mezzanine debt is the same as the borrower of the senior debt (rather than a holdco entity sitting above the senior borrower) aspects of the rights of the mezzanine lender will also be restricted in inter-creditor documentation, including the right to accelerate.

Mezzanine debt commonly has higher interest rates and fees than senior debt because of the higher risk associated with the debt and the restricted rights that are imposed where an inter-creditor arrangement is required.

Mezzanine debt is often used as a means of reducing the equity commitment that an investor is required to provide upfront.

Debt capital markets

The issuance of bonds, notes and other debt securities into a variety of capital markets internationally and domestically has traditionally been a funding method used by the domestic A-REIT sector to obtain longer tenor and diversify the investor’s funding sources. Given the availability of funding in the US debt capital markets, this has become a significant source of debt funding over recent years for the A-REIT sector.

The issuance of the debt securities is usually a market reserved for portfolio investors and rarely seen in a development context.
Equity

When seeking debt funding to acquire or develop a property, financial institutions will only provide finance up to a proportion of the value of the property, usually between 55 per cent and 75 per cent, depending on the risk profile of the financial institution and whether mezzanine debt is used to partly finance the transaction. The investor will be required to contribute the additional funds necessary to acquire or develop the property from alternative non-debt sources. These funds are usually provided through an initial equity injection.

Progressing a development through the initial planning stages to a point where the developer can seek finance from a financial institution is a time-intensive process and can be expensive. Investors often use equity to fund the initial planning stage of the development. All necessary equity (and mezzanine debt) funding injections will need to have been made in full before a senior debt financier will provide the senior debt.

The following issues should be considered with respect to equity funding:

- the return on capital required by the equity provider(s); and
- the rights sought by the equity provider(s) with respect to the development or acquisition (this is particularly relevant if equity provider(s) wish to provide funds via a subordinated loan).

Security and other support

To secure the repayment of any debt borrowed, a financier will seek security over the property to be acquired or developed and the assets of the investor. Financiers will often also seek security over the shares/units in the investor and/or a guarantee from the parent company, as well as tripartite agreements with the builder and developer. Each of these is discussed further in the sections below.

Security over property is typically taken by way of a real property mortgage and is regulated by legislation in each state and territory of Australia. Security over other classes of assets is subject to the Personal Property Securities Act 2009 (Cth) (the PPSA).

If debt is sourced from multiple tiers, then clear and well documented rights will need to be established as to the terms on which additional security can be granted and the rights of the different secured financiers.

Mortgages

The granting of a mortgage provides the financier with specific rights over that property, including the right to inspect the property and, following an event of default, the right to appoint a receiver, take possession and sell the property.

Each Australian state and territory has its own specific rules about the form of mortgages granted over property, as well as specific requirements to verify the identity of the people signing the mortgage.

Other assets

The following should be noted with respect to charges over the assets of the investor and/or the shares/units in the investor owned by the parent company:

- the granting of a charge over all of the assets of an investor may restrict how the entity can use certain assets, when it can sell its assets and how insurance proceeds with respect to those assets should be applied;
- the granting of a charge over shares in an investor by its shareholder will restrict the ability of the shareholder to sell those shares; and
any charge to which the PPSA applies will be registered on the Personal Property Securities Register (the PPSR) to ensure that the security is perfected and is enforceable. Please note that the general public can access the PPSR.

Guarantees

Financiers will often look to the parent company for credit support in the form of a guarantee and indemnity. In addition, a parent company may also be asked by the financiers to provide stand-by support in the form of a guarantee to cover any cost overrun associated with a construction development.

Builder and developer tripartite agreements

As mentioned, a financier will want security over all the assets of the investor, including the investor’s rights under key contracts such as the building contract.

In addition to taking security, the financier needs to ensure that the key contracts will continue to operate after enforcement of the security (and after any insolvency of the investor). The value of security over the property will be reduced if the builder has terminated the building contract and leaves a development in an incomplete state.

Accordingly, financiers often enter into a tripartite agreement with the builder (and, separately, the developer) to ensure these contractual rights are protected.

Key terms in finance documents

Reporting and monitoring

The financier’s primary concerns will be ensuring that:

- their loan will be repaid; and
- the value of the property is maintained.

The primary source of repayment will, in the case of a development, be from the sale of the development, whereas with an acquisition, the source of repayment will be from the cash flows generated from the property (in the case of interest obligations) and the ability to sell the property for a sufficient price (in the case of repayment obligations).

The finance documents will be drafted to ensure that the financier is kept updated on how the investor is performing financially and the value of the property. The finance documents will also include financial covenants that will be tested at specific intervals.

With development finance, the financier will appoint a quantity surveyor who will sign off on the technical nature of the development as part of the initial due diligence and who will then monitor construction costs through to completion. The quantity surveyor will also be called on to fairly value progress payments and any variations to the building contract.

Financier due diligence requirements

Before providing any finance, financiers will undertake extensive due diligence about the investor and the property. The due diligence will primarily relate to the following:

- a property valuation to the satisfaction of the financier;
- due diligence on the property and key acquisition or development documents (for example, building contacts and leases);
a review of all relevant authorisations in respect of purchasing the property or developing the site;
financial statements of the investor and cash flow projections;
evidence as to insurance;
presale contracts, if any, that relate to the property. The financier will primarily be concerned that each presale contract meets the following criteria:
  • the form of the presale contract complies with the applicable property legislation;
  • the purchase price has been approved and at least a 10 per cent deposit has been paid;
  • the purchaser has no right to rescind or terminate the contract following the insolvency of the investor;
  • any required approval from the Foreign Investment Revenue Board has been obtained (often accompanied by a cap on sales to entities requiring approval from the FIRB);
  • that the settlement date aligns with the date for practical completion; and
material leases, if any, that relate to the property. The financier will primarily be concerned that the leases meet the following criteria:
  • the form of the lease complies with the applicable property legislation;
  • the identity of the anchor tenant and the term of the lease;
  • appropriate rent is payable over the term of the lease; and
  • the tenant has no right to rescind or terminate the contract following the insolvency of the investor or breach of the terms of the lease by the investor.

Financial covenants

The key financial covenants included in property finance documents are as follows:

› **Loan to value ratio**: This ratio seeks to ensure that the funds provided by the financier do not exceed a specified percentage of the value of the property (normally up to 55 per cent to 65 per cent for senior debt financing and up to 75 per cent or higher if mezzanine debt is included in the calculation). This will be calculated as the principal outstanding under the loan(s) divided by the value of the property set out in the most recent valuation accepted by the financier.

› **Interest cover ratio**: This ratio seeks to ensure that the cash flows generated from the property are sufficient to cover the interest payment obligations of the investor with respect to all of its borrowed debt, with appropriate headroom. This will usually be calculated as net rent divided by the aggregate of all interest expenses.

› **Weighted average lease expiry**: This ratio weights the expiry of leases to mitigate the risk of key leases expiring in the short term.

› **Cost to complete ratio**: This ratio seeks to ensure that the cost of completing the development does not exceed the funds available to the investor, including both equity and debt. This calculation will be checked by the quantity surveyor appointed by the financier.
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