

# INVESTING DOWN UNDER

A GUIDE FOR GLOBAL REAL ESTATE INVESTORS



# Investing Down Under

## Welcome to our Guide for Global Real Estate Investors

### WHY AUSTRALIA?

At the time of writing, many global investors are considering where and when to tack next into the headwinds of de-globalisation (with a deepening rift on trade between China and the United States, and a looming Brexit), disruptive technologies (and the impact of those technologies on productivity), and a ‘lower for longer’ interest rate environment – and, simultaneously, how they will navigate in a market flooded with increasing volumes of capital pushing asset valuations ever higher and suppressing returns.

The real estate market is, at the same time, late into a relatively elongated (by historical measures) ‘super’ cycle, the beginnings of which were catalysed by the monetary and fiscal policy and measures implemented to stimulate economic recovery from the effects of the Global Financial Crisis. While conjecture remains as to when the cycle will end, most market commentators would agree that the current market is displaying all of the typical characteristics of a late cycle market – including the inversion of major sovereign yield curves and high asset valuations driven by the volume of increasingly fungible capital chasing returns in a low interest rate environment.

In Australia, this super cycle has (to date) seen one of the largest ever real estate merger transactions in Unibail-Rodamco’s A\$32 billion acquisition of Westfield, the delivery of world class urban regeneration projects (such as the Barangaroo, Wynyard and Quay Quarter precincts in Sydney, and the Collins Square and Docklands precincts in Melbourne), the emergence of private equity and other ‘non-bank’ finance as entrepreneurial alternative sources of capital and drivers of value creation, and advances in technology all operate to sustain and grow a world class real estate sector.

Despite the late cycle characteristics, long term fundamentals, a considered foreign investment regulatory framework, and a continuing focus on structural refinement are combining to ensure Australia remains attractive to global investors in the competition for allocation of capital into real estate.

One of the pillars underpinning Australia’s continuing strong fundamentals has been a sustained commitment by government (at both Federal and State levels) to the development of world class infrastructure to support the growth of Australia’s gateway cities. Key infrastructure policy statements and papers, and increasingly open dialogue with the private sector in

relation to value capture and alternative funding models, have provided a stimulus for major infrastructure development and urban renewal projects that are designed to meet the demand for greater connectivity both within and between cities.

Another pillar is the highly securitised nature of the market, which has, over time, resulted in one of the world’s most transparent and liquid real estate markets. Real estate investment trusts (or REITs), both listed and unlisted, have been a feature of the Australian market for close to 50 years and have been a significant conduit for foreign capital flowing into Australia’s real estate markets.

These conditions have created significant opportunities for investors with foreign sources of capital, including private equity, pension funds and sovereign wealth funds. These opportunities are enhanced by taxation concessions for certain foreign investors, under the MIT regime, which makes the taxation of rental income and capital gains from real estate investments in Australia competitive in a global market.

### THE GUIDE

For those considering investing in Australian real estate assets, Investing Down Under offers an overview of the initial legal, taxation and structuring issues you may need to consider. There is also a summary of key practical considerations and the risk mitigation strategies often used in the acquisition of direct or indirect interests in Australian real estate assets.

Of course, this guide is not an exhaustive analysis or a replacement for tailored professional advice.

If you would like more information or to discuss your investment options, simply [contact a member of our team](#).

### THE KWM TEAM

Investing Down Under is a collective effort of the King & Wood Mallesons Real Estate sector group. The group has extensive cross-border experience and has been involved in some of the largest and most complex real estate investments and developments in the Asia-Pacific region. King & Wood Mallesons is a leading global law firm headquartered in Asia and focused on connecting Asia to the world and the world to Asia.

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# HOW FOREIGN INVESTMENT IN AUSTRALIAN REAL ESTATE IS REGULATED

## Foreign Investment in Australia is Regulated

### FOREIGN INVESTMENT REGIME

Foreign investment in Australia is regulated principally by the Foreign Acquisitions and Takeovers Act 1975 (Cth) (FATA). The Australian Federal Treasurer administers the FATA with the advice and assistance of the Foreign Investment Review Board (FIRB).

There are specific circumstances where foreign investors can purchase residential real estate in Australia. Outside of these circumstances, purchases are prohibited. Investments in non-residential real estate may be treated less sensitively under the foreign investment regime, but in many cases will still require the issue of a prior no objection notification.

The foreign investment process should be seen as a hurdle to be cleared, rather than a likely roadblock to investment. The vast majority of applications receive a no objection notification from the Treasurer (commonly referred to as "FIRB approval"). Some FIRB approvals are made subject to conditions that must be complied with. In the real estate sector, the Treasurer often imposes conditions on the development of vacant land and the holding of developed residential property. Acquisitions of non-sensitive developed commercial property generally do not raise national interest concerns.

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This advice is specific to real estate investment. Separate advice should be obtained in respect of investment in Australian companies or businesses as necessary.

## TRANSACTIONS THAT REQUIRE FIRB APPROVAL

Where a proposed acquisition of real estate falls within the scope of the FATA, a foreign investor will need to consider whether they must provide prior notification to the Treasurer (through FIRB) of the acquisition and seek FIRB approval.

For the FATA to apply, the acquiring entity must be a foreign person. The concept is broader than the ordinary meaning of those words and is extended to include:

Ordinance. You are required to provide the following information to the Companies Registry when incorporating a new limited liability company.

- a natural person who is not ordinarily resident in Australia
- a corporation, trustee of a trust or general partner of a limited partnership where a natural person not ordinarily resident in Australia, or a corporation incorporated overseas, holds 20% or more of the corporation
- a corporation, trustee of a trust or general partner of a limited partnership in which two or more of those persons, or corporations, hold 40% or more of the corporation
- a foreign government or foreign government investor
- another person prescribed by the Foreign Acquisitions and Takeovers Regulation 2015 (**Regulations**).
- Whether notification is required will depend on the following:
  - whether the investor is a foreign government or non-government investor
  - the type of acquisition
  - whether the acquisition is subject to

monetary or interest thresholds

- Australia's commitments under its free trade agreements (**FTAs**).

## RESIDENTIAL REAL ESTATE

All acquisitions of residential real estate by foreign persons will require approval. Different approaches are taken depending on whether the real estate in question is an established dwelling, a newly constructed dwelling, or vacant land.

### Established dwellings

Established dwellings which have been previously owned or occupied are considered sensitive and proposed acquisitions by foreign persons are not normally approved except in particular, narrowly defined circumstances. (This includes an interest in a time share scheme, unless the interest of the foreign person and any associates in the aggregate is not greater than 4 weeks in any year).

Approvals for acquisition of established dwellings are typically subject to conditions, and are generally limited to the following circumstances:

- foreign persons who are temporary residents can apply to purchase an established dwelling for use as their residence in Australia, but must sell it within three months of it ceasing to be their primary residence;
- foreign persons that operate a substantial Australian business can apply to purchase established dwellings to house their Australian based staff; and
- foreign persons can purchase established dwellings for redevelopment, provided the redevelopment increases Australia's housing stock.

### Newly constructed dwellings and vacant land

Applications from foreign persons seeking to acquire newly constructed dwellings or vacant land will usually be approved with few restrictions as these acquisitions are seen to help support economic growth. For vacant

land, proposals are normally approved subject to the condition that development completes within 4 years.

Note that the Government intends for residential property to not be kept vacant. As a result, a vacancy fee (equivalent to the FIRB filing fee) is imposed where a property is not occupied for 6 months or more in a 12-month period following the acquisition of the property. The period for which the ATO will assess liability is the vacancy year, which is the 12 months beginning after the first day the foreign person acquires the right to occupy the property (for example the settlement date). A vacancy fee return is required to be lodged after the end of that 12-month period each year.

## COMMERCIAL LAND

Commercial land includes vacant and developed land, such as offices, factories, warehouses, shops, and commercial residential premises (for example hotels, motels and caravan parks).

### Vacant land

All foreign persons are required to seek approval for acquisitions of vacant commercial land, regardless of the value of the land.

### Mining and production tenements

Generally foreign persons are required to seek approval for acquisitions of interests in mining or production tenements, regardless of the value of the land.

An exception to this requirement is if the investor is from the USA, New Zealand or Chile in which case investors must seek approval for acquisitions greater than \$1,154 million.

### Developed land

Whether approval is required to acquire developed commercial properties depends on the nature of the investor, the nature of the property, and the value of the interest to be acquired.

Agreement country investors (see below) are only required to seek approval where the value of the interest is greater than \$1,154 million.

Foreign government investors (see below) are required to seek approval for any interest, regardless of value.

For all other foreign persons, approval will be required where the value of the interest exceeds \$266 million, unless the property is sensitive land. If the property is sensitive land a lower \$58 million threshold applies.

Sensitive commercial land includes:

- land to be leased to the Commonwealth, a State or Territory
- land used for sensitive businesses, such as data storage, media and telecommunications
- land used to store, handle or dispose of biological agents or other goods for which a licence is required
- land under prescribed airspace
- land used to house servers for a financial institution or stock exchange
- mines, quarries, oil and gas wells
- land used for purposes related to the Australian Defence Force
- land used for other public or critical infrastructure.

## AGRICULTURAL LAND

Agricultural land is defined as "land in Australia that is used, or could reasonably be used, for a primary production business".

Primary production refers to production resulting from the cultivation of land; animal husbandry/ farming; horticulture; fishing; forestry; viticulture or dairy farming. However, this agricultural land does not include land that is wholly or predominantly used for mining, environmental conservation, wildlife sanctuary, industrial estates, tourism and recreation, fishing and aquaculture, or land of less than one hectare.

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Foreign persons must get approval for a proposed acquisition of an interest in agricultural land where the cumulative value of agricultural land owned by the foreign person (and any associates), including the proposed purchase, is more than \$15 million.

Consistent with Australia's FTA commitments, a \$1,154 million threshold applies to Chilean, New Zealand and United States investors, and a \$50 million threshold applies to Thai investors. These thresholds are not cumulative.

## EXEMPTION CERTIFICATES

An application may be made under the FATA for an exemption certificate that will allow the acquisition of interests in land over a period (which can be up to 36 months) within a certain expenditure cap with regular reporting of activity undertaken within the period.

An exemption certificate in respect of interests in land is considered on a case by case basis. An applicant needs to have a sufficient volume of proposals to qualify for consideration.

## EXCEPTIONS

There are a number of circumstances in which foreign persons are not required to seek FIRB approval for acquisitions of interest in Australian real estate. These include:

- acquisition of land by will or devolution by operation of law
- compulsory acquisitions and buy-out
- certain interests acquired under a rights issue or dividend reinvestment plan
- acquisitions by Australian citizens not ordinarily resident in Australia, New Zealand citizens and permanent residents
- foreign nationals purchasing property as joint tenants with their Australian citizen, New Zealand citizen, or permanent resident spouse (does not include purchasing property as tenants in common)

- a charity operating in Australia primarily for the benefit of persons ordinarily resident in Australia
- investors ordinarily in the business of moneylending (specific rules apply for interests in residential land and for foreign government investors).

## AGRICULTURAL LAND REQUIREMENTS

### Foreign Ownership Register

In 2015 the Australian Taxation Office (ATO) took responsibility for the Agricultural Land Register. All foreign individuals, companies and trustees are now required to notify the ATO if they:

- have an existing interest in agricultural land
- have a new interest in agricultural land
- no longer have an interest in agricultural land.

Similarly, foreign persons are required to notify the ATO if they hold, or cease to hold, particular water entitlements. These include:

- an irrigation right to an Australian water source
- a right to hold or take water from an Australian water source
- a contractual water right reasonably likely to exceed 5 years.

New interests in agricultural land or water must be registered within 30 days. Penalties may apply if a person fails to register an interest or change in interest.

### Marketing Process

FIRB policy requires foreign investors to demonstrate that the land they are looking to acquire has been offered for sale publicly in an open and transparent sale and process, and 'widely marketed' for a minimum of 30 days. This is required for agricultural land intended to be used for a primary production business or for residential development.

This process will generally require public marketing using channels that Australian

bidders could reasonably access such as real estate listing websites and national or regional newspapers.

## FEE REGIME

FIRB imposes significant fees for foreign investment applications.

The following fees apply to foreign investment in the Australian property market:

### Residential property

Fees relating to the acquisition of residential property are tiered per \$1 million of consideration.

- For properties valued at \$1 million or less the fee payable will be \$5,600.
- This rises proportionately at about \$11,300 per million and is uncapped.
- Where the fee otherwise payable would be more than 25% of the consideration for the acquisition, the fee will be \$1,000.

The full list of residential fees is available at: [firb.gov.au/resources/guidance/gn29](http://firb.gov.au/resources/guidance/gn29)

Foreign owners of residential real estate may be required to pay an annual vacancy fee in respect of a property, if that property is unoccupied for at least 6 months in a 12-year period. Generally, the annual vacancy fee will be equal to the fee that was payable in respect of the foreign investment application for the property.

### Commercial land

- \$2,000 if the consideration is \$10 million or less;
- \$25,700 if the consideration is more than \$10 million but not more than \$1 billion;
- \$103,400 if the consideration is over \$1 billion.

### Agricultural land

- \$2,000: for land acquisitions of \$2 million or less
- \$25,700: for acquisitions of land if the consideration is more than \$2 million but not more than \$10 million;

- \$103,400 if the consideration is more than \$10 million.

These are large fees and will need to be factored into investors' decision-making processes. It is hoped that the fees do not create a disincentive for investment in the property market.

## PENALTY REGIME

The regime imposes strong penalties for investors who breach the foreign investment rules. While the penalties are primarily aimed at residential investments, they will impact a range of transactions.

The maximum criminal penalties are:

- individuals – 750 penalty units (\$157,500) or 3 years imprisonment
- company – 3,750 penalty units (\$787,500).

Civil penalties may also be sought for alleged contraventions. The maximum civil penalty varies depending on the nature of the breach.

An infringement notice may be issued rather than pursuing a civil penalty. The amount due will be significantly lower where a person has notified the Commonwealth of a contravention before the infringement notice is issued.

### Third Parties

The penalty regime has also been extended to third parties who knowingly assist investors to breach the rules. The maximum civil penalty for a third party who has assisted in a contravention will be the same as the maximum penalty for the primary breach.

Third parties caught assisting in a breach may also be prosecuted for knowingly assisting another person to commit a criminal offence under Section 11.2 of the Commonwealth Criminal Code Act 1995.

### Recent enforcement

The ATO has recently been taking steps to enforce Australia's foreign investment laws, with a particular focus on residential real estate. The ATO reports that these efforts

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have resulted in the forced divestment of 316 properties, between January 2015 and December 2018, which were illegally acquired by foreign nationals.

Given the fee and penalty regimes, care will need to be taken to ensure of the right foreign investment outcome when looking at investment in the property sector.

## ASSESSMENT AND CONSIDERATIONS

Proposals are assessed against a national interest test. There is no definition of “the national interest” in FATA and applications are assessed by FIRB and the Treasurer on a case by case basis. There is no obligation on the investor to demonstrate that positive benefits to Australia will flow from the proposal.

When assessing FIRB applications, the Treasurer and FIRB will have regard to the Government’s foreign investment policy and to other relevant legislation and will treat certain sectors as sensitive. Additional restrictions may apply to certain acquisitions, including residential land, mines, media and telecommunications related acquisitions.

During the assessment process, FIRB will circulate the proposal among relevant federal and state government departments and other bodies, such as the ACCC and ATO, to ascertain their views as to whether the proposal is contrary to the national interest.

The Treasurer may attach conditions to a statement of no objection where compliance with the conditions is necessary in order to prevent the proposal from being contrary to Australia’s national interest. Any approval conditions must be complied with by the investor. Often FIRB approvals are conditional on a range of tax related conditions aimed at ensuring tax compliance by foreign investors seeking FIRB approval for their proposals.

## Timeframe

Once a proposed acquisition is notified to FIRB and Treasury has received the application fee, the Treasurer has 30 days (from the time of receipt of the filing fee) to decide whether or not to object to the acquisition and a further 10 days to notify the applicant of the decision. Where the Treasurer considers that further time is required to assess a proposal, an interim order may be made extending the time to up to a further 90 days. Notifications under the Policy are not subject to a statutory deadline.

## ADDITIONAL REQUIREMENTS

In addition to approvals under FATA, certain types of acquisitions may have special requirements.

For instance, ownership of land in Queensland is impacted by the Foreign Ownership of Land Register Act 1988 (Qld). This legislation does not prevent foreign ownership of land but merely records it. It does require registration by foreign persons who already own an interest in land. The Queensland Government policy on foreign investment is to ensure an approach consistent with that adopted by FIRB.

## SPECIAL CONDITIONS FOR CERTAIN TYPES OF FOREIGN INVESTORS

### Agreement Country Investors

Higher notification thresholds typically apply for investors that are from nations with whom Australia has applicable free trade agreements. Currently, investors from the United States, New Zealand, South Korea, Chile, Japan, China, Singapore, Canada and Mexico are Agreement Country Investors. Australia has recently entered into a free trade agreement with Hong Kong at the time of writing. Accordingly, Hong Kong are expected to be added to this list in the near future.

An Agreement Country Investor is an entity that is an enterprise or national of an agreement country. A branch of an entity that

is not itself an enterprise of the country may qualify if the branch is located in an agreement country and other criteria are satisfied. It is important to note that a prescribed enterprise’s subsidiary incorporated outside of the prescribed country, including one incorporated in Australia, does not benefit from the higher thresholds.

Acquisitions by Agreement Country Investors of interests in Australian business entities and property valued below the relevant threshold are exempt from the need to notify FIRB and obtain prior approval.

The following Agreement Country Investor thresholds apply for the 2019 calendar year:

- \$266 million for business acquisitions of 20% or more in prescribed sensitive sectors
- \$1,154 million for business acquisitions of 20% or more in non-sensitive sectors
- \$1,154 million for developed commercial property
- for investors from the US, New Zealand and Chile, \$1,154 million for agribusiness acquisitions of 20% or more, and \$1,154 million for agricultural land
- for investors from China, Japan, Singapore and South Korea, \$15 million cumulative for agricultural land
- for investors from Thailand, \$50 million for agricultural land
- for investors from China, Japan, Singapore and Korea, \$58 million for agribusiness acquisitions of 10% or more.

## Foreign government investors

FATA provides that foreign government investors include:

- a body politic of a foreign country
- entities in which foreign governments, their agencies or related entities from a single foreign country have an aggregate interest (direct or indirect) of 20% or more
- entities in which governments, their agencies or related entities from more than one foreign country have an aggregate interest (direct or indirect) of 40% or more
- entities that are otherwise controlled by foreign governments, their agencies or related entities, and any associates, or could be controlled by them including as part of a controlling group.

Any acquisition of an interest in Australian real property by a foreign government investor must be notified to FIRB for prior FIRB approval.

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# INVESTMENT VEHICLES

## Direct and Indirect Investment

It is crucial when making or realising any investment that the transaction is appropriately structured to ensure that adverse or other unintended legal, accounting or tax consequences do not arise.

Investments in Australian real estate assets can be made either through the direct acquisition of real estate, or, indirectly, by acquiring ownership of a corporate or trust structure that holds the target asset. The choice of investment style (e.g. direct or indirect) and investment vehicle is a key part of structuring a proposed transaction and will be influenced by a number of factors, including legal, accounting and tax considerations.

A summary of the types of structures and vehicles available to investors, together with certain regulatory considerations, is set out below.

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Investment Structure	Key Features	Regulation
Trust/Managed investment schemes (MIS)* (wholesale investors)	<ul style="list-style-type: none"> <li>Managed by a trustee and/or investment manager</li> <li>If investors will all be wholesale, then the trust will not need to be registered as a MIS</li> </ul>	<ul style="list-style-type: none"> <li>MIS needs to operate under an Australian Financial Services License (AFSL) (the AFSL is usually held by the trustee, although there is flexibility for it to be held by the investment manager or by an external party through representative and/or intermediary arrangements)</li> <li>Also regulated by the general law of trusts</li> </ul>
Trust/MIS* (retail investors)	<ul style="list-style-type: none"> <li>Managed by a trustee/responsible entity (RE) and/or investment manager</li> <li>If there will be retail investors, the trust may need to be registered as a MIS – however, this also allows the fund to raise capital from a larger pool of such potential investors</li> </ul>	<ul style="list-style-type: none"> <li>Usually needs to be registered as a MIS</li> <li>If registered, there is a heavier regulatory and compliance burden (additionally, there are likely to be disclosure compliance obligations if the investors are retail)</li> <li>If registered, RE must be a public company and hold an AFSL</li> <li>Also regulated by the general law of trusts</li> </ul>
Company	<ul style="list-style-type: none"> <li>Managed by its directors</li> <li>Members rights are governed by the constitution and/or a shareholders' agreement</li> </ul>	<ul style="list-style-type: none"> <li>Regulated by the Corporations Act 2001 (Cth) (<b>Corporations Act</b>)</li> <li>In some cases disclosure to investors may be required for capital raising purposes</li> </ul>
Joint Venture	<ul style="list-style-type: none"> <li>Rights are governed by joint venture agreement, a unitholders' agreement (where the joint venture vehicle is a trust) or a shareholders' agreement (where the joint venture vehicle is a company)</li> <li>Can be used in conjunction with all the above structures</li> <li>Enables co-operation with other market participants – e.g. ability to access other market participants' resources (financial or other expertise)</li> </ul>	<ul style="list-style-type: none"> <li>Regulation can depend on the type of the joint venture vehicle (e.g. a trust or company) – see above</li> </ul>

\*A trust needs at least two members to be a managed investment scheme.

## ESTABLISHING A PRIVATE UNIT TRUST

Direct investments in Australian real estate assets usually occurs through an existing Australian investment entity, or a new investment entity established for the purpose of acquiring the target asset.

Target assets are usually acquired and held through a trust structure, rather than through a company structure, because a trust that invests in real estate can, subject to certain requirements, be treated as a “flow-through” entity for taxation purposes. Australian tax concessions are also available for certain global investors if the trust through which they hold their interest in Australian real estate qualifies as a Managed Investment

Trust (MIT). There is also greater flexibility to return capital to investors under trust structures. [Managed investment trusts: tax concessions](#) and [Taxes that apply to Australian Real Estate investments](#) contain more detail on the taxation treatment of Australian trusts.

## ACQUIRING A PRIVATE UNIT TRUST

Investments in real estate assets may be made indirectly by way of acquisition of units in an existing private unit trust which already holds the target asset.

Where a direct acquisition of the target asset held by a trust is available, a buyer will usually choose to do so, rather than acquiring the units in the trust that already holds the target asset.

This is because:

**A**

additional corporate, financial, accounting and taxation due diligence on the trust and the trustee is usually required to be undertaken on an acquisition of units in a unit trust, to assess the extent of the assets and liabilities that are being acquired.

**B**

if all of the units in the trust are being acquired, the stamp duty payable is generally the same as the stamp duty that is payable on a direct real estate investment.

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## Basic Guide to Trust Law in Australia

<p><b>Nature of a trust</b></p>	<p>Under Australian law, a trust is not a separate legal entity. A trust is a relationship between a trustee and the beneficiaries in respect of certain property. The trustee is appointed by and must act in accordance with the trust deed establishing the trust.</p> <p>Under a unit trust, the relative interests of the beneficiaries (investors) are represented by the number and classes of units held</p>
<p><b>Management of the trust</b></p>	<p>The trust is managed by a trustee, which is invariably a corporate entity, and it is the trustee that holds the legal title to the real estate and any other assets of the trust. The corporate trustee can be a company that is controlled by the investors in the trust (where the trust is a subsidiary or closely held) or, as is increasingly common for global investors, a professional trustee company (a so called “trustee for hire”) can be appointed. It is common, particularly where there is a professional trustee appointed, for there to be a separate investment manager appointed to assist the trustee in managing the trust.</p>
<p><b>Powers, duties and limitations of the trustee</b></p>	<p>The powers, duties and limitations of the trustee and any restrictions on the creation and transfer of units in the trust are usually set out in the trust deed, which is supplemented by legislation in the various states and territories and equitable principles applicable to trusts</p>
<p><b>Regulatory</b></p>	<p>Unit trusts may be public or private. If the unit trust is private, in the sense that all the investors are professional investors or otherwise “wholesale investors”, then the trust itself will not generally be regulated by the Corporations Act, although the activities of the corporate trustee and/or the investment manager will be. If the trust is registered as a MIS, the trust will be regulated by the Corporations Act.</p> <p>The legislation governing Australian companies is the Corporations Act, which is a federal Act. This law is administered by the Australian Securities &amp; Investments Commission (<b>ASIC</b>).</p>
<p><b>Licensing</b></p>	<p>If the trust is also a managed investment scheme, it must operate under an AFSL. The AFSL may be held by the trustee, or in some circumstances by the investment manager or by a third party (who may authorise the investment manager or trustee to operate the trust under its AFSL) through representative and/or intermediary arrangements.</p>
<p><b>Rights and obligations of unitholders</b></p>	<p>If there are a small number of unrelated unitholders, there would usually be a separate unitholders’ agreement regulating the rights and obligations of the unitholders as between themselves and the trustee in respect of things such as restrictions on dealings with the units (including change of control), pre-emptive rights, financial management of the trust and dealings with the real estate and other assets of the trust. In some cases, these matters may also be dealt with in the trust deed.</p>
<p><b>Tax administration requirements</b></p>	<p>If a foreign investor establishes a trust to invest in Australian real estate, the trustee of the trust will need to comply with the relevant Australian tax administration obligations associated with the establishment and operation of the trust.</p> <p>In particular, the trust will need to obtain a tax file number (<b>TFN</b>) and lodge tax returns each year. Further, as trusts generally are “flow-through” entities for tax purposes, the trustee of the trust will need to perform tax calculations each year to determine how much the unitholders or beneficiaries of the trust are taxed on the income of the trust each year. External service providers can be engaged to assist in this process.</p> <p>How these calculations are undertaken, and the information that is required to be provided to unitholders or beneficiaries by a trustee will also depend upon whether or not the trust is eligible to, and has elected to be, an “attribution managed investment trust” (<b>AMIT</b>) for Australian tax purposes. The trustee of the trust may also wish to consider whether to register for Goods &amp; Services Tax (<b>GST</b>).</p>

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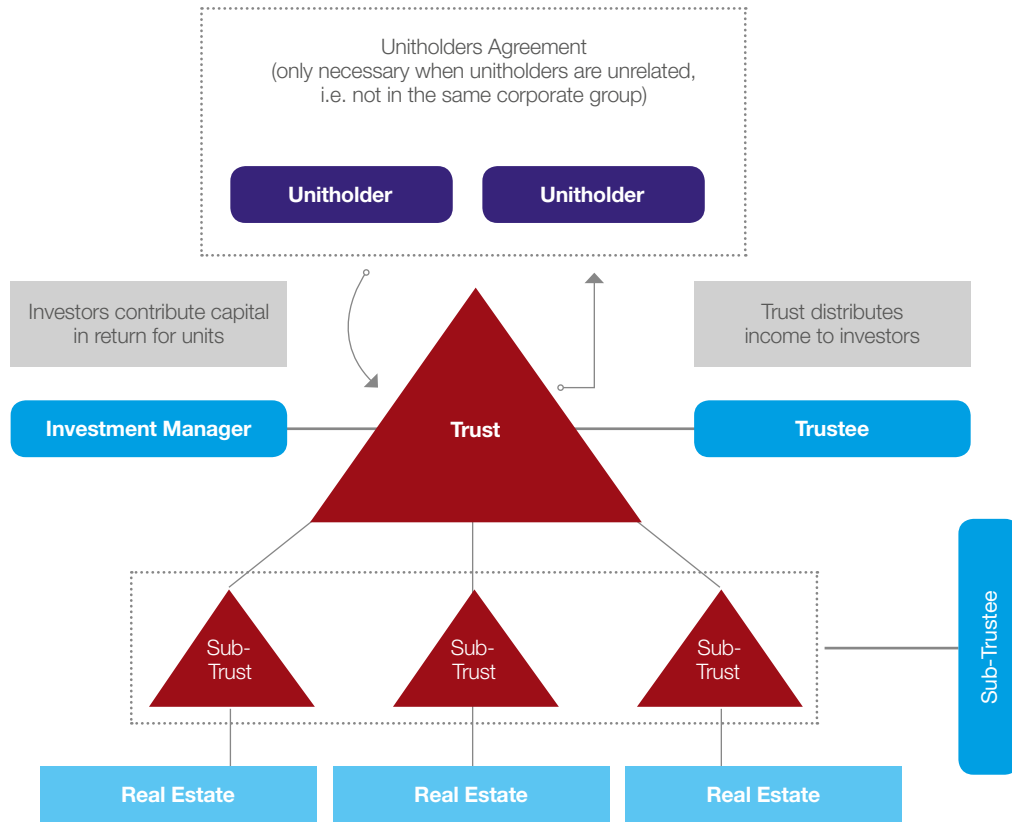
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## TYPICAL STRUCTURE

The diagram below illustrates the features of a unit trust/MIS described above, and shows a typical structure through which a unit trust/MIS may be used to invest in real estate. This structure shows the use of sub trusts to hold multiple real estate assets.



## INDIRECT INVESTMENT THROUGH AN AUSTRALIAN SUBSIDIARY COMPANY

In Australia it is possible, although less common, for the reasons outlined in [Establishing a private unit trust](#), to hold a real estate investment through a company structure. It is also relatively common for global investors using a trust structure (where

the trust is to be a subsidiary or closely held) to establish their own corporate trustee. This paragraph sets out the regulatory framework that applies to Australian companies.

The most common form of company in Australia is a company limited by shares, which may be a proprietary company (private) or a public company.

## COMPANIES

### PROPRIETARY (PTY LTD)

- must have at least one shareholder but no more than 50 non-employee shareholders
- must have at least one director who is ordinarily resident in Australia
- can, but need not, have a secretary
- cannot engage in any activity that would require the lodgement of a prospectus (except for an offer of shares to existing shareholders or employees, or where another exemption under Chapter 6D of the Corporations Act applies – e.g. small scale offerings)
- must adhere to the reporting obligations contained in Part 2M.3 of the Corporations Act
- a large proprietary company must appoint an auditor
- must have a public officer for tax purposes
- must have a registered office in Australia

### PUBLIC (LIMITED)

- must have at least one shareholder
- must have at least three directors (two of whom are ordinarily resident in Australia)
- must have at least one secretary who is ordinarily resident in Australia
- subject to securities and other applicable laws, may issue a prospectus for the offer of shares, debentures or other securities
- must appoint an auditor
- must have a public officer for tax purposes
- must have a registered office in Australia
- may, but need not, be listed on ASX



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In the context of real estate investments where the number of shareholders is limited, it is more common to use a proprietary company due to the additional disclosure requirements, financial reporting and administrative burden associated with a public company.

## FOREIGN COMPANY REGISTRATION

A foreign company is prohibited from carrying on business in Australia unless it is registered as a foreign company or is conducting business through an Australian subsidiary. This registration requirement is separate from, and in addition to, the AFSL requirements and applies to foreign companies generally which carry out activities with the necessary connection to Australia.

## EXTERNAL OR INTERNAL MANAGEMENT

In the traditional structure, unlisted and listed A-REITs are typically managed by an “external” responsible entity or “trustee for hire” (i.e. the ownership and control of the responsible entity is separate from ownership of units in the scheme and underlying real estate). More recently, as demand by members of schemes for greater alignment of interests by management of such schemes escalates, many A-REITs have moved towards internally managed structures to accommodate this rising investor sentiment, as evidenced by the increasing trend towards stapled structures (see Investment in Stapled Securities).

## INDIRECT INVESTMENT BY ACQUIRING UNITS IN A REIT

Another means of indirect investment is to acquire units in a real estate investment trust (REIT). Australia has a mature and sophisticated REIT market. REITs are structured as trusts and are governed by a well-developed legal and regulatory framework. REITs can be listed on the Australian Securities Exchange (ASX) or remain unlisted. Wholesale property funds are one type of unlisted REIT. REITs which are listed are now known as A-REITs. REITs (and in certain cases private unit trusts) are a form of MIS and are regulated accordingly.

## INVESTMENT IN STAPLED SECURITIES

Stapled structures are common in Australia, particularly for A-REITs. Stapled securities are securities which comprise a unit in an A-REIT and a share in a company<sup>1</sup> that owns management or development rights for certain real estate. The “staple” refers to the requirement that the unit in the A-REIT and the share in the company be traded together as a single security – one cannot be dealt with independently of the other.

Stapled structures are usually developed in a way that provide for the A-REIT part of the structure to invest in real estate for the purpose of deriving rent, and for the corporate part of the structure to carry on the other activities, such as property development or property management. If properly structured, the A-REIT will not be taxed as a company under Australia’s “trading trust” rules and may be taxed on a “flow through” basis.

[See tax trusts for more details of the trading trust rules.](#)

Accordingly, a stapled structure may allow the “flow through” rental income from the A-REIT to be coupled with the potential upside of development profits and other non-rental income, through activities carried out via the company. Relevantly however, legislation has recently been enacted that impacts, amongst other things, the rate of withholding for certain trusts that are MITs, in circumstances where the MIT has derived certain income under a cross-stapled or other prescribed arrangements. There is an exclusion from these new provisions however, for cross-staple rental income that is derived from third parties and the corporate side of the staple continues to pay corporate tax. See [Withholding tax concessions](#) for more details about these proposed amendments.

## REGULATORY REQUIREMENTS

Most trusts investing in real estate will be “managed investment schemes” under the Corporations Act. This is because they typically involve the contribution and pooling of money or money’s worth for investment in a scheme to produce financial benefits (e.g. rental return from real estate) where members receive “interests” (i.e. units) in the scheme, the members are not all related to each other and to the trustee, and the members in the scheme do not have day-to-day control over the operations of the scheme.

All listed REITs and some unlisted REITs will be required to be registered as a managed investment scheme under the Corporations Act (see the table below). An exception to the requirement for registration is that a scheme will not need to be registered if, under the Corporations Act it would be exempt from the requirement to issue a Product Disclosure

Statement.<sup>2</sup> This would be the case if all the investors are “wholesale clients” as defined under the Corporations Act. There are also a variety of other exemptions from registration requirement contained in the Corporations Regulations which may apply; for example, where offers are made to offshore investors.<sup>3</sup>

Failure to register the managed investment scheme in breach of the requirement to register may lead to the scheme being wound up by order of the Court.<sup>4</sup> Additionally the Corporations Act imposes criminal penalties of 600 penalty units<sup>5</sup> (or in the case of a body corporate, 6,000 penalty units<sup>6</sup>) and up to 5 years imprisonment.<sup>7</sup>

Private or wholesale trusts may also be voluntarily registered (e.g. if the tax concessions for MITs make this desirable, see [Managed investment trusts: tax concessions](#)).

There are additional compliance and disclosure obligations for a registered scheme, as well as statutory duties and financial requirements imposed upon the responsible entity and its officers in connection with the performance of the functions conferred on it by the Corporations Act and the scheme’s constituent documents.

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1. This can also be a trust or other vehicle that is taxed as a company.

2. This exception is found in section 601ED(2) of the Corporations Act, which provides that a managed investment scheme does not have to be registered if all the issues of interests in the scheme that have been made would not have required the giving of a Product Disclosure Statement under Division 2 of Part 7.9 if the scheme had been registered when the issues were made.

3. Corporations Regulations 2001 7.9.07FB modifying section 1012D(8) of the Corporations Act.

4. Section 601EE of the Corporations Act.

5. A penalty unit is currently \$210 (section 4AA(1) of the Crimes Act 1914 (Cth)), Item 163 of Schedule 3 of the Corporations Act and section 1311B of the Corporations Act.

6. Section 1311C of the Corporations Act and Item 163 of Schedule 3 of the Corporations Act.

7. Item 163 of Schedule 3 of the Corporations Act.

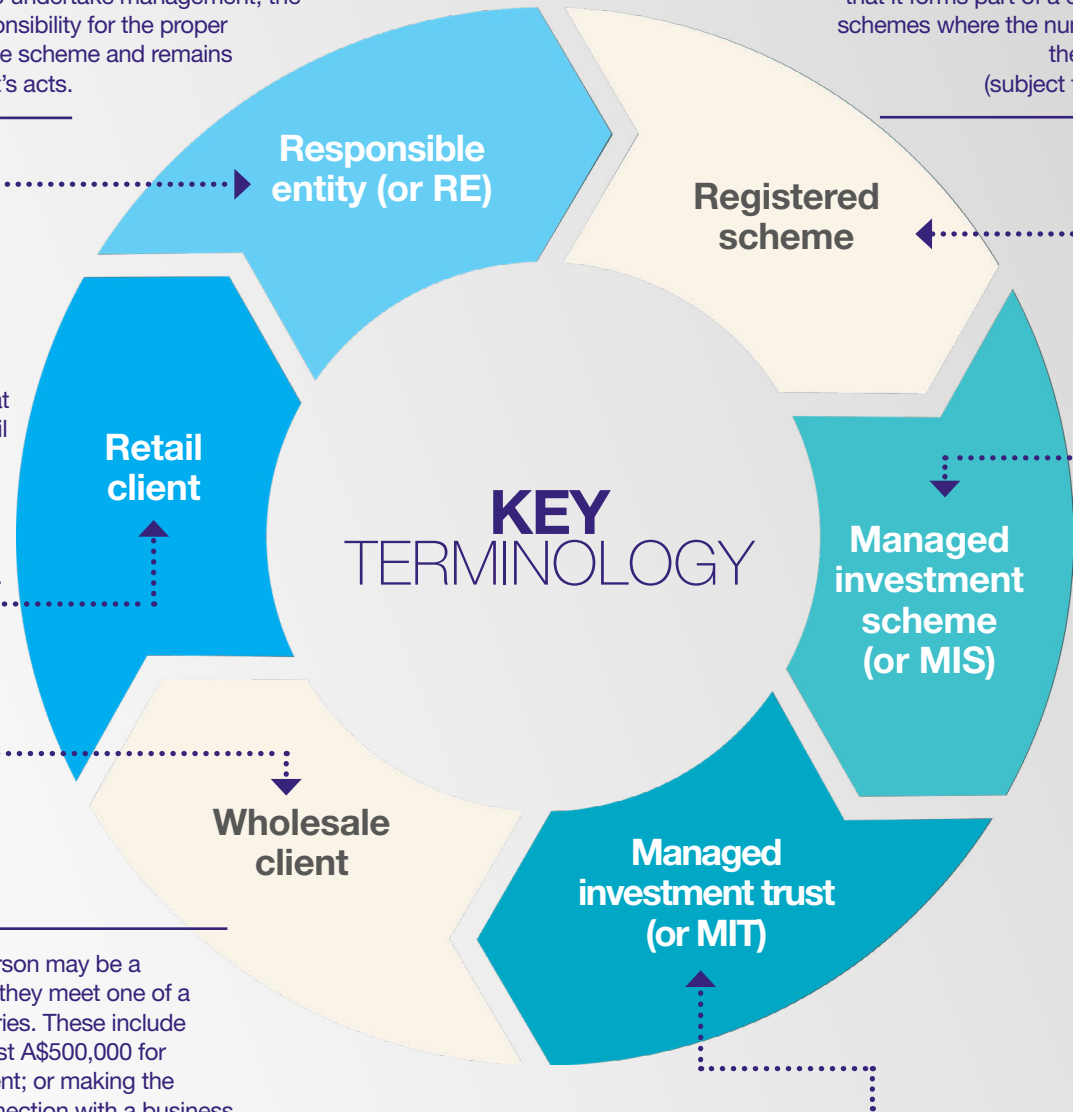
A trustee of a registered scheme must be a responsible entity. This entity has the dual responsibility as trustee and manager of a MIS, and although it may appoint a third party entity to undertake management, the RE bears full responsibility for the proper management of the scheme and remains liable for the agent's acts.

A MIS must be registered if it has more than 20 members, was promoted by a promoter of schemes or ASIC has made a determination that it forms part of a closely related group of schemes where the number of all members in the schemes exceeds 20 (subject to certain exemptions).

The general presumption is that a person is a "retail client" unless they fall within one of the wholesale client categories.

Very broadly, a person may be a wholesale client if they meet one of a number of categories. These include contributing at least A\$500,000 for the initial investment; or making the investment in connection with a business that is a small business (ie, has more than a specified number of employees); or the investor having net assets of A\$1.5 million or gross income for each of the last 2 years of at least A\$250,000.

## KEY TERMINOLOGY



There are favourable tax concessions which apply to trusts which qualify as a MIT. To qualify as a MIT, the trust must satisfy certain requirements, including that the trust must be widely held, meet certain regulatory requirements and have a substantial portion of the investment management activities for the Australian assets of the trust performed in Australia. Some of the requirements operate differently depending on whether the trust is an unregistered wholesale trust, a registered wholesale trust or a registered trail trust.

### REMOVAL OF RE

If a registered scheme is:

- unlisted: removal of the RE requires at least 50% of total votes that may be cast by members entitled to vote (including those members who are not present) (extraordinary resolution)
- listed: removal of the RE requires at least 50% of the votes actually cast by members entitled to vote present in person or by proxy (ordinary resolution).

Ordinarily the RE of a registered scheme and its associates are not entitled to vote on a resolution of the scheme if they have an interest in the resolution other than as a member. However, if the scheme is listed, the RE and its associates are entitled to vote on resolutions to remove the responsible entity and choose a new responsible entity.

### WINDING UP REGISTERED SCHEME

The constitution may include a power for the registered scheme to be wound up at a specified time, in specified circumstances or on the happening of a specified event. Such a specified event may include, for example, the giving of a notice by the RE to members, or a vote (typically by extraordinary resolution) of members. In addition to exercising any power under the constitution, the RE may wind up a registered scheme if its purpose has been accomplished or cannot be accomplished.

### CONSTITUTIONAL CHANGES

- The constitution of a registered scheme may be amended by:
- special resolution of members (requiring at least 75% of members present and voting), or
- unilaterally by the RE if the RE reasonably considers the change will not adversely affect members' rights

Members contribute and pool money or money's worth to derive financial benefits and in return receive interests in a scheme in which they do not have day-to-day control over the operations.

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## ADDITIONAL REGULATION APPLICABLE TO LISTED A-REITS

Listed A-REITs have additional duties and obligations attached to them by the Corporations Act, including:

- **takeovers prohibition:** broadly, a person and their associates are prohibited from acquiring more than 20% of the interests in a listed A-REIT without being required to make a formal takeover offer or obtain member approval of the target entity to the acquisition
- **substantial holder disclosure:** mandatory disclosure requirements which oblige members (including their associates) holding an interest of more than 5% (or a movement of at least 1% in their interests once they have a substantial holding) in a listed A-REIT to disclose their interest (or the change in their substantial holding) to the ASX.

In addition to being subject to the Corporations Act, listed A-REITs are also subject to the Listing Rules and must notify the ASX of information which may have a material effect on the price or value of interests in the scheme. These rules require immediate disclosure of price sensitive information subject to limited carve outs.

## DISCLOSURE REQUIREMENTS OF MANAGED INVESTMENT SCHEMES

If units in a MIS are not exclusively offered to investors who are “wholesale clients”, and those investors are in Australia, the responsible entity of the scheme must issue a product disclosure statement (**PDS**). The PDS must comply with prescriptive statutory standards and set out certain information about the units as may be required for the purpose of enabling a retail client to make a decision about whether to acquire the units. There are some exemptions for small scale offerings and other prescribed situations.

There are also ongoing disclosure requirements, such as continuous reporting obligations, which apply to registered schemes.

## FINANCIAL SERVICES LICENSING

The RE must be a public company and requires an AFSL authorising it to operate that scheme.

In addition, many trustees of unregistered wholesale or private unit trusts will also require an AFSL if they carry on a “financial service” in Australia, unless an applicable exemption applies.

To obtain an AFSL, the applicant will need to satisfy various financial and non-financial requirements set by ASIC, including:

- **in the case of financial criteria,** net tangible assets, which can exceed \$10 million<sup>8</sup> (applicable to REs and/or external custodians); and in certain circumstances surplus liquid funds of A\$50,000
- **in the case of non-financial criteria,** evidence that the trustee has adequate resources available to provide the financial services covered by the licence and to carry out supervisory arrangements and adequate risk management systems.

The process of applying for an AFSL is extensive and requires the applicant to provide detailed information and documentary evidence of its organisational expertise and the qualifications and experience of its key personnel. AFSL holders will have an extensive range of obligations imposed on them, including the requirement to submit a profit and loss statement audit report to ASIC<sup>9</sup> containing an auditors’ report displaying compliance with the financial requirements imposed on the AFS licensee by ASIC.<sup>10</sup> Additionally REs must submit a more extensive audit report containing greater detail relating to its cashflow projections and financial resources.<sup>11</sup>

As foreign financial services providers cannot normally satisfy the requirements to obtain an AFSL, they generally seek to identify one or more exemptions from the AFSL regime and ensure they comply with the conditions of those exemptions so as not to breach Australian financial services licensing laws.

## CORPORATE COLLECTIVE INVESTMENT VEHICLES (CCIVs)

From 2017 to early 2019, bills were released for the potential establishment of CCIVs. The introduction of CCIVs would provide an investment vehicle that operates in a similar way to a MIS but with liability limited by shares in a company structure. The company would be taxed under equivalent rules for attribution managed investment trusts but with some refinements. These features present an opportunity for investment in Australia by foreign investors who are not familiar with investments in trusts. As at the date of this guide, it is not clear whether CCIVs will be used generally to invest in real estate – there is uncertainty as to the stamp duty treatment of CCIVs. This will be something that develops post-introduction of the regime.

8. ASIC Regulatory Guide 166, table 9.

9. Section 989B of the Corporations Act.

10. ASIC Regulatory Guide 166.63.

11. ASIC Regulatory Guide 166.208.

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# MANAGED INVESTMENT TRUSTS

## Tax Concessions

### BACKGROUND

A number of tax concessions are available for Australian investment vehicles that qualify as Managed Investment Trusts (MITs) for tax purposes. These concessions are designed to encourage investment into Australia, particularly Australian real estate, by both resident and non-resident investors, through the use of investment vehicles which are structured as MITs.

A trust must satisfy a number of requirements in order for it to qualify as a MIT and access these concessions.

Not all trusts will qualify as MITs, so global investors that are seeking to invest in Australian real estate assets through a MIT should ensure that the relevant trust qualifies as a MIT. Most importantly, the activities of the MIT must be, in simple terms, investing in land for the purpose or primarily for the purpose of deriving rent or undertaking certain other prescribed investments.

### REQUIREMENTS TO BE A MIT

Qualification as a MIT will be relevant for:

- withholding concessions
- capital account election
- the attribution (or **AMIT**) regime.

While there are common elements, the relevant requirements that must be satisfied to qualify as a MIT are complex and ultimately depend upon the relevant concession. Some of the requirements include:

- the trust must be a MIS
- the trust must be an Australian resident, or the central management and control of the trust must be in Australia
- the trust must satisfy certain “widely held” requirements that require the trust

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to have a minimum number of members (or must be deemed to have a certain number of members). The requirement varies depending upon whether the trust is registered or unregistered

- the trust must not fall within certain “concentration of ownership” exclusions that prevent trusts from qualifying as MITs if a particular number of persons (other than certain qualifying investors) hold specified percentages of the trust.

A trust may also satisfy the requirements to be a MIT where it is itself wholly owned by a MIT.

In certain circumstances where a trust qualifies as a MIT, the relevant trust will only be eligible to be a “withholding MIT” and therefore make eligible distributions at the concessionary withholding rate of 15% if a “substantial proportion” of the investment management activities of the trust are carried out in Australia with respect to assets of the trust that are situated in Australia or that are share, units or interests listed for quotation on an Australian stock exchange. This may require foreign investors to appoint an Australian manager for trusts established to hold Australian real estate assets. This requirement is relevant only where the trust is seeking to obtain the benefit of the reduced withholding tax concessions.

The “widely held” requirement and the “concentration of ownership” exclusions operate differently depending on whether the trust is a registered MIS or not, or if the trust is wholesale or retail. Further, if any members of the trust fall within certain categories of institutional investors, the “widely held” requirements and “concentration of ownership” exclusions will be much more easily satisfied. Such investors include, for example, certain complying superannuation funds, life insurance companies, foreign collective investment vehicles and sovereign wealth funds. Accordingly, foreign investors that fall within any of these categories, or who co-invest in a trust with an entity that falls within any of these categories, are likely to find the MIT requirements significantly easier to satisfy.

## WITHHOLDING TAX CONCESSIONS

The most important MIT tax concessions for global investors in Australian real estate are the reduced rates of withholding tax that apply to “fund payments” made by MITs to unitholders that are resident in an exchange of information (EOI) jurisdiction. In particular, the usual 30% withholding tax rate that applies to certain trust distributions to non-resident companies may be reduced to 15%.

These concessions provide that “fund payment” distributions – being distributions of any amounts aside from dividends, interest and royalties (such as rent or capital gains on Australian real estate assets) – are taxed at a rate of:

- 15% for foreign resident investors that are resident in an EOI jurisdiction
- 30% otherwise.

The list of EOI jurisdictions includes the jurisdictions with which Australia has an “effective exchange of information” agreement.

Many of Australia’s main trading partners (such as the US, UK, Singapore and Japan) are EOI jurisdictions. There are a number of important exclusions from the EOI list such as Hong Kong.

Recently, legislation has been enacted in Australia which limits the extent to which a MIT can distribute certain income derived at the concessional 15% withholding tax rate. Broadly, these amendments apply to distributions from 1 July 2019 and will result in passive income that is earned:

- via a stapled structure in circumstances where the income is “cross staple arrangement income” of the passive trust (for example, a MIT); or
- in respect of agricultural land and residential housing (other than affordable housing and commercial residential premises).
- being subject to withholding tax at the corporate tax rate (currently 30%).

Income will not, however, constitute “cross staple arrangement income” if, by way of example:

- the rental income is derived from a stapled entity that carries on business or trading activities, where the cross-staple rent can be traced to the amount of third party rent from land investment charged by an operating entity;
- the rent is attributable to an approved economic infrastructure facility;
- the income is, or is attributable to, a capital gain that arises because an operating entity acquires an asset from the passive trust; or
- the income satisfies the de minimis rule (broadly, 5% of the passive trust’s assessable income (disregarding net capital gains) for the previous income year).

Only limited transitional relief is available.

## CAPITAL ACCOUNT ELECTION

MITs can also make a “capital account election”, which allows them to obtain concessional capital gains tax (rather than ordinary income) treatment on gains made on the disposal of certain types of assets.

Obtaining capital gains tax treatment is valuable for foreign resident investors, as such investors may obtain the benefit of the foreign resident capital gains tax exemption upon distribution of the capital gain if the asset disposed of by the MIT is not “taxable Australian property”. It is also valuable for Australian investors, who can offset such capital gains against their capital losses and may claim the capital gains discount to reduce the amount of their taxable capital gain.

## ATTRIBUTION REGIME FOR ELIGIBLE MITs

MITs that satisfy the relevant requirements are able to elect into the AMIT or attribution regime. The AMIT regime is intended to provide greater certainty regarding the tax consequences of investing in certain MITs and

reduce the tax administration associated with operating MITs.

The regime also provides a different basis for the taxation of a MIT and its unitholders (being tax on an attribution rather than distributable basis). Other aspects of the regime, such as the integrity rule which will assess the trustee of a MIT on non-arm’s length income (subject to certain exclusions) apply to MITs generally, not just those that elect into the attribution regime.

## STRUCTURING MIT INVESTMENTS AND EXITS

As a result of these concessions, there can be significant advantages for global investors to structure their investments in Australian real estate through MITs and, in certain circumstances, to co-invest in such structures with other investors.

It is therefore important when making or realising any investment that the transaction is appropriately structured.

For example, where a MIT with foreign resident investors invests in Australian real estate and one of the investors wishes to exit their investment, it may be preferable for the realisation to occur at the level of the MIT, rather than at the level of the foreign resident investor. This is because, if a MIT makes a capital gain on the disposal and distributes it to the foreign resident investor, the concessional MIT withholding tax rate of 15% is likely to apply to the capital gain, whereas if the foreign resident investor sold their units in the MIT, they would likely have to pay capital gains tax on the gain at a rate of at least 30% (if the foreign resident investor was a company).

In addition, on any exit, this may result in the trust ceasing to qualify as a MIT (for example, if the qualifying person test is no longer satisfied). This again will need to be managed as part of the exit arrangements.

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# TAXES THAT APPLY TO AUSTRALIAN REAL ESTATE INVESTMENTS

## Taxation of Australian Real Estate

### **TAX – TRUSTS (OTHER THAN AMITs)**

Generally, trusts that are not taxed as companies under the “public trading trust” rules are not separately taxed in Australia if there is at least an amount of trust income and the beneficiaries / unitholders are presently entitled to all of the income of the trust in an income year.

Broadly, the trust taxation rules provide for the beneficiaries, rather than the trustee, of a trust to be taxed on the share of the taxable income of the trust based on the share of the trust income which the beneficiary is “presently entitled”. However, to the extent that the trust does not fully distribute all of its trust income, the trustee may be required to (proportionately) pay tax on the taxable income of the trust at the top marginal tax rate (currently 47%).

If a beneficiary is a non-resident of Australia, a trustee of a trust may be required to withhold (under the general trust taxation rules and/or the MIT provisions) from distribution payments to that non-resident beneficiary at the required rate. However, a trust may be taxed as if it were a company if the public trading trust rules apply. Generally speaking, a trust is likely to be treated in this way if it:

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- **conducts a “trading business”**. That is, it engages in any activities other than an “eligible investment business”, which is defined restrictively as investing or trading in various types of passive investments, such as investing in land for the purpose of deriving rent

- **is a “public unit trust”**. That is, it is offered to investors (or owned by certain prescribed categories of investors) and does not have ownership that is too concentrated.

Due to the broad definition of a “trading business”, foreign investors who invest in Australian real estate through a trust should be careful to properly restrict the activities of a trust so that it is not a “public trading trust” and taxed as if it were a company. To this end, it may be useful to engage external service providers to manage and operate any Australian real estate investment that is made through a trust, or to implement a stapled structure (see [Investment in stapled securities](#)).

Please refer to [Managed investment trust - tax concessions](#) for information on the taxation concessions available to MITs.

## TAX – TRUSTS (AMITs)

Under the AMIT regime, a trustee of an AMIT should not itself be subject to Australian tax in respect of the taxable income of the trust in circumstances where the unitholders of the trust are “attributed” all of the taxable income of the trust.

This attribution will be based on the amount and character of taxable income which the trustee chooses to attribute to the unitholders.

One of the benefits of the AMIT regime is that it provides an opportunity for income to be retained in the trust, but for the tax on the net (taxable) income of the trust to still be passed to the unitholders of the trust.

In order for the AMIT regime to apply, a non-revocable election must be made by the trustee of the trust. If an election was made

and that trust subsequently failed to satisfy the requirements to be an AMIT in the future, unitholders would be taxed pursuant to the non-AMIT regime (as set out above).

## TAX – COMPANIES

For the reasons set out in [Establishing a private unit trust](#) of this guide, it is less common for an Australian real estate investment to be made through a company, rather than a trust. However, foreign residents may need to consider the Australian corporate tax regime if they establish an Australian company to act as a trustee of a trust or if they invest in Australian real estate through a company.

As a general rule, a company will be an Australian resident for tax purposes if it is:

- incorporated in Australia
- not incorporated in Australia but carries on business in Australia and has either its central management and control in Australia or its voting power controlled by shareholders who are residents of Australia.

Australian resident companies are subject to tax in Australia on all of their income, regardless of source, at a recurrent rate of 30%.

## FOREIGN RESIDENTS – INCOME AND DISPOSAL OF INTERESTS

Foreign resident companies can also be subject to tax in Australia in circumstances where:

- the income derived has an “Australian source” and the foreign resident is not able to rely upon a double tax agreement
- notwithstanding being able to rely upon a double tax agreement, the interest that is being disposed of constitutes “taxable Australian real property” (for example, if units in a trust are disposed of, the value of all of the underlying Australian real property assets of the trust (whether directly or indirectly held) are greater than the trust’s other assets.

## Non-resident capital gains withholding tax

From 1 July 2016, where a foreign resident disposes of certain taxable Australian property, the purchaser will be required to withhold a non-final withholding tax at a rate of 12.5% of the purchase price, and remit the amount withheld by the Australian Taxation Office. There are certain exemptions and exclusions from the new regime, which need to be considered having regard to the underlying interest that is being disposed of or acquired.

## STAMP DUTY

In Australia, stamp duty is payable on a number of different transactions, including the purchase of real estate. Each of the states and territories have their own stamp duty regimes and impose duty on a range of different transactions. As such, the same transaction could have different stamp duty implications depending on the jurisdiction in which the subject property is located.

Each Australian State and Territory levies transfer duty on the transfer of land or any interest in land in that State or Territory. A direct acquisition of real estate in Australia will therefore be subject to stamp duty in the particular State or Territory in which the target asset is located.

An indirect acquisition in Australian real estate made by way of an acquisition of shares in a company or units in a unit trust may also give rise to a liability duty known as “landholder duty”. For landholder duty to apply:

- the target company or unit trust must have land valued at or above a certain threshold, which differs across the states and territories (e.g. currently \$500,000 in Northern Territory or \$2 million in NSW)
- the interest acquired must itself entitle the acquirer to an interest in the “landholder” at or above the acquisition threshold which applies to the specific State or Territory. Broadly speaking, the acquisition thresholds in each Australian State or Territory depend on whether the specific

“landholder” is a company or unit trust, and whether or not that entity is listed on the ASX or a recognised securities exchange (e.g. the acquisition threshold in NSW is 50% in a private unit trust scheme or private company), or

- the interest acquired does not itself entitle the acquirer to an interest at or above the acquisition threshold but the interest, when aggregated with other interests held by the acquirer or its associates results in an aggregated interest in the “landholder” above the acquisition threshold.

In addition to the duty which apply to direct and indirect acquisitions of land as outlined above, a number of states (currently NSW, Victoria, Queensland, South Australia, Western Australia and Tasmania) have also introduced what is commonly referred to as a “foreign purchaser surcharge”. Broadly speaking, the surcharge applies where a “foreign person” directly or indirectly acquires “residential land”. The meaning of “foreign person” and “residential land” varies between the jurisdictions. The surcharges range between 3% and 8%.

The statutory liability to pay transfer duty in Australia is generally borne by the buyer. However, in Queensland and South Australia, the transacting parties are jointly and severally liable to pay the duty (although the usual commercial practice is for the buyer to pay the duty).

## GST

Investment in Australian real estate will generally be subject to Goods and Services Tax (GST). GST is a broad-based tax payable on ‘taxable supplies’. It is calculated at the rate of 10% on the value of the supply of a broad range of goods, services, rights and other things acquired in, or in connection with, Australia. It is conceptually similar to the value added taxes operating in many OECD countries.

With the exception of GST payable on the sale of new or potential residential property

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(which is required to be paid to the ATO by the purchaser), the liability to remit GST is on the supplier of the GST items. On a transfer of real estate, this would be the seller. However, the seller will usually seek to recover its GST liability from the recipient, namely the buyer, under the contract of sale.

If the buyer is carrying on an enterprise and is registered (or required to be registered) for GST purposes, in most cases it will be able to claim an input tax credit equal to the GST included in the price paid for those acquisitions for which the supplier is liable. Accordingly, it is intended that the GST liability will flow through the supply chain to the end consumers who will ultimately bear the cost of the GST because they are not registered (or required to be registered) and so cannot claim input tax credits.

A transfer of units in a unit trust (which holds an interest in Australian real estate) is not subject to GST, as it is a financial supply. The same result should apply to a transfer of shares in a company which holds an interest in Australian real estate.

An entity must register for GST if it is carrying on an enterprise in Australia and its current or projected annual turnover is equal to or exceeds the relevant threshold, which is generally \$75,000. An entity may also be required to register even if it is not carrying on an enterprise in Australia but is making supplies that are connected with Australia and its annual turnover of supplies connected with Australia exceeds the relevant threshold.

The concept of an entity is very broad for GST purposes; it extends beyond natural persons and companies to include entities which are not legal entities, such as trusts, partnerships and government entities. This is the case even though such entities may not be considered an entity under the general law.

An entity who is carrying on an enterprise in Australia may choose to register even if it does not meet the turnover threshold (discussed above). An entity should consider

the benefits of voluntary registration. Benefits include the entitlement to claim input tax credits (which cannot be claimed if the entity is not registered). Input tax credits can offset the GST included in the price paid for GST items acquired and GST on importations if they are for use in carrying on its enterprise.

- “Going concern” concession

The “going concern” concession is important for investments in Australian real estate. For instance, if certain requirements are met, then the transfer of real estate may be GST-free. If a building is transferred with leases and service contracts in place, then generally the transfer should be treated as a “supply of a going concern” and will thus be GST-free. The “going concern” concession from GST is particularly useful because stamp duty is imposed by the various states and territories on the purchase price plus any GST “margin scheme” concession.

The “margin scheme” is a concessional scheme which allows GST payable on the transfer of real estate to be reduced, subject to agreement by the buyer and the seller. If the margin scheme applies, GST is payable on the margin between the sale price and either the amount the seller paid for the property or (if the seller acquired the property before 1 July 2000) the value of the property provided in an approved valuation as at 1 July 2000 (which is when GST was introduced in Australia), rather than on the sale price. The margin scheme can be used by sellers who purchased the sale property before 1 July 2000. However, if the sale property was purchased after 1 July 2000, the margin scheme can only be used by sellers in certain limited circumstances (for example, if the seller acquired the sale property using the margin scheme).

If the parties apply the margin scheme to a sale of real estate, the buyer will not be able to claim input tax credits for GST paid. This makes the application of the scheme appropriate primarily where the end buyer would not be able to claim input tax credits (and so a reduction in the GST amount is worthwhile); for instance, where the buyer is not registered for GST or is a private individual.

## LAND TAX

Land tax is imposed by each of the states and territories on the ownership of real estate within the State or Territory (but only on certain vacant land in the Northern Territory). Land tax is levied annually on the unimproved value of all non-exempt land held by the “owner”. In general, land tax is not levied on property if it is a principal place of residence of the owner who is a natural person or is exempt under the relevant land tax legislation. Victoria also has a special regime which imposes a trust surcharge (at rates higher than the ordinary rates) on landholdings held on trust if the total taxable value of the land that the trust owns is more than \$25,000 but less than \$3,000,000. Technically speaking, if the trust has landholdings with total taxable value of more than \$3,000,000, the trust surcharge is still levied in place of the ordinary rates (but its rates are the same as the ordinary rates).

In addition, a number of states (currently NSW, Victoria, Queensland and ACT) imposes a land tax surcharge (or absentee surcharge) on foreign or absentee holders of residential land (although in Victoria, the absentee surcharge applies in respect of all land). This additional surcharge ranges between 0.75% and 2%.

## MUNICIPAL RATES

Municipal rates are the most common levy imposed on the value of land serviced by local or municipal governments.



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# DEBT FINANCING OF AUSTRALIAN REAL ESTATE INVESTMENTS

We expect the trend of increased presence and activity of non-bank financiers in the Australian real estate market to continue – but that banks will, to position themselves for the next cycle, become more proactive in preserving key borrower client relationships, and which will require more overt engagement by banks with select market participants.

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For non-bank financiers, at this stage of the market cycle, the opportunity is perhaps most acute for those that have the capability to apply an 'equity' informed lens to the assessment of specific opportunities – such as the increased demand for 'capex heavy' loans that combine elements of investment and development facilities for assets in need of added value (for example, to adapt to a more service centred tenant requirements).

## AVAILABILITY OF DEBT FINANCE

While debt from Australian banks remains the primary source of finance for investment in Australian, the trend in recent years has been for investors to diversify their capital base by incorporating mezzanine finance and debt from foreign banks (such as Singapore and Japan). While the leverage ratios that banks are willing to accept remain at current levels or continue to decrease, and in the case of residential developments, the required level of presales remain at current levels or continue to increase, we expect to see an increase in the use of mezzanine and offshore financing in Australian real estate transactions.

## USUAL TERMS OF FINANCING

Australian financiers will only finance the acquisition or development of property once certain conditions have been satisfied. At a minimum, financiers will require the following conditions to be satisfied:

- obtaining a valuation of the subject property
- confirmation that the amount the financier is prepared to lend as a proportion to the value of the real estate complies with the financier's "loan to value ratio" (LVR) requirements.

The LVR required depends on the purchaser of the property, the nature of the property being acquired and the purchaser's relationship with the financier (if any). Where the purchaser is a REIT and the property being acquired is commercial real estate, it is common to see an LVR in the range of 50-60%;

- security (preferably first ranking) is granted in favour of the financier
- the property and any improvements on it are insured by an insurance policy which notes the financier's interest
- the financier is satisfied with its legal due diligence with respect to the property (typically comprising a title analysis and investigations as to any pre-sales or rental income).

In the case of residential developments, the financier will want to be satisfied that there is a certain level of pre-sales, and that those pre-sales are arm's length transactions which achieve certain commercial terms and are enforceable under consumer protection legislation that applies to residential real estate acquisitions at the federal and state levels.

It is common for a financier to also place a restriction on the level of pre-sales to foreign purchasers, given the additional cost and procedural risk associated with attempting to enforce contracts of sale in other jurisdictions

## PERSONAL PROPERTY SECURITIES

Security interests in personal property are governed by the Personal Property Securities Act 2009 (PPSA). The PPSA is directed at personal property and covers securities such as retention of title, bailments, sales of receivables and intangible assets, but there are cross over impacts on real estate transactions and financing.

The PPSA applies to security interests in personal property and sets up a system of registration, priority and enforcement. The priority of a security interest can be perfected by registering the interest on the new PPSA register or by having control or taking possession of the relevant property. Without this perfected interest, a security holder will be vulnerable to the claims of other parties who, although they may have obtained an interest later in time, have a better claim because they have perfected their interest.

The PPSA will not apply to a lease of land or fixtures. However, to the extent that a lease

of land also includes a lease of goods (or unfixed items of plant and equipment), that lease will be a PPSA security interest which must be registered in order to protect the secured party's interest. Otherwise, a person with a security interest registered against the tenant, or a liquidator of the tenant, may have a superior interest in those goods or items of plant and equipment even though the landlord is the owner of the goods.

PPSA issues also arise in any financing transaction where a financier is taking security over rent accounts, goods located on the property or intellectual property connected with a business conducted from real property.



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Australia is a federation comprised of six states and three mainland territories

The states are New South Wales (**NSW**), Victoria (**VIC**), Queensland (**QLD**), South Australia (**SA**), Western Australia (**WA**) and Tasmania (**TAS**) and the mainland territories are the Australian Capital Territory (**ACT**), the Northern Territory (**NT**) and the Jervis Bay Territory.

The laws affecting real estate investments have their source in both government legislation and regulation (at Commonwealth, state and local government levels) and the general law developed by the courts.

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# COMMONWEALTH / FEDERAL

The Commonwealth has power derived from the federal Constitution to legislate in relation to specific areas including corporations, trade and commerce, taxation, banking and foreign investment. For example, the Corporations Act is the legislation that governs managed investment schemes, financial services licensing and foreign company registration.

# STATE & TERRITORY

Subject to Commonwealth laws, the states and territories make laws which apply to their own jurisdiction. It is the state-based legislation that covers many general property matters, including land title and environmental matters.

# LOCAL GOVERNMENT

Local governments (or councils) provide governance for communities at a more local level, including on environmental aspects, permitted uses of land and building approvals. There are usually many local government areas and bodies within a capital city of each State and Territory.

# COURTS

Legislation is supported by case law (known as common law) which is developed through decisions of the courts. The system of binding precedent requires the courts to consider the precedent established in earlier cases, and in this way Australian real estate law is progressively developed and adapted.

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# HOW AUSTRALIAN REAL ESTATE CAN BE OWNED

## FREEHOLD

Freehold ownership (otherwise known as an estate in fee simple) is unlimited by time. This is the most common form of real estate ownership in Australia. The freehold owner can grant a lease out of the freehold for a limited period, but full ownership will ultimately revert to the freeholder or its successors.

## LEASEHOLD

Leasehold ownership has a finite limit. The leasehold owner is granted exclusive possession of specific real estate for a specified period of time. Leasehold interests for commercial real estate are usually granted for fixed periods.

The owner of a leasehold estate is typically required to pay an annual rent (in monthly instalments). If the lease is for a long term (of, say, 99 years), an upfront premium may be payable when the lease is granted instead of an annual rent.

## CROWN LAND

Crown land is the term used to describe land which is owned by the Commonwealth, a state or a territory within Australia.

The Crown's power to sell, lease or otherwise dispose of Crown land is usually subject to conditions and restrictions contained in state-based legislation. There are parts of Australia, such as the ACT, where long term leases of Crown land are a common form of ownership.

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# HOW TITLE TO AUSTRALIAN REAL ESTATE IS ESTABLISHED

## Title to Australian Real Estate

### REGISTERED LAND

#### Torrens system of registration

Australia operates a system of land registration known as the Torrens system. Under this system, title to real estate is created by the act of registration. This means that on a sale of Torrens system land, the buyer obtains legal title on registration of the transfer, rather than on execution of the instrument of transfer.

Most, but not all, of the land in Australia is Torrens system land. Exceptions are considered in [unregistered land](#).

#### State-based public register

Each State or Territory maintains a real estate register, which is a State or Territory government-run public repository of information on real estate tenure and interests.

Although the rules, requirements and forms differ across the jurisdictions, the register contains title information and details of registered interests affecting the land. Examples of registered interests include easements, restrictive covenants, mortgages and leases.

Title to Torrens system land is recorded on a certificate of title which is issued by and kept at the registry in either electronic or paper form (depending on the State or Territory). For those States and Territories that still issue

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paper certificates, a duplicate certificate of title is issued to the registered owner.

### Electronic Conveyancing

Conveyancing is the process of transferring ownership and other interests in real estate from one person to another, and typically involves the preparation, verification and lodgement for registration of a range of legal documents and instruments. The conveyancing industry in Australia is undergoing a digital transformation with a nation-wide roll-out of an electronic lodgement and settlement system known as PEXA.

The PEXA system provides a secure online portal to an electronic workspace where registered parties (such as legal and conveyancing practitioners, financial institutions, and government bodies) can

complete and lodge instruments, verify stamp duty and complete transfer of funds, and otherwise settle in real time the transfer of interests in real estate.

### Indefeasibility

In Australia, the Torrens system is underpinned by a principle known as 'indefeasibility'. Registration of title provides indefeasibility – that is, once a transfer or grant of title to the land is registered then, as a general rule, the title cannot be defeated by other unregistered interests. This means that on registration, the registered owner of the land acquires its interest subject to earlier registered interests but free from all unregistered interests (even if the acquirer knew about those unregistered interests), other than a number of statutory exceptions. The exact scope of these exceptions

varies between the respective states and territories, but generally includes fraud, short-term leases, easements, misdescription of boundaries and, sometimes, adverse possession.

Legislation in most states and territories provides for compensation to be payable to persons who suffer loss as a result of the operation of the system, for instance where fraud occurs or there is an error or omission in the registry.

In practical terms, the effect of indefeasibility of title is that a buyer of real estate in Australia can generally rely on the certificate of title as evidence of title. Time and expense do not need to be incurred in investigating title beyond the register, other than in respect of the specific statutory exceptions. Title insurance is generally not obtained as part of

real estate acquisitions in Australia, where the target asset is Torrens system land.

### UNREGISTERED LAND

Not all land in Australia is registered and so the Torrens system of title by registration does not always apply.

The two main types of unregistered land are unalienated Crown land (that is, land owned by the Commonwealth, a State or a Territory that has not previously been the subject of a grant of title) and land falling under the old pre-registration system (known as 'general law' land).

If land of either type is the subject of an investment, additional due diligence is undertaken as there is no registered title to rely on.

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# HOW LEASES IMPACT THE INVESTMENT VALUE OF AUSTRALIAN REAL ESTATE

## Commercial leases are the product of negotiations between a landlord and a tenant

The value of commercial real estate will be affected by leases granted by the owner of that real estate. Commercial leases in Australia are the product of negotiations between a landlord and a tenant (usually also being the owner of the relevant real estate) typically through a real estate leasing agent acting on behalf of the landlord.

Lease terms in Australia are subject to market standards and practice, and there are also terms implied by legislation and common law. In particular, there is a large body of retail tenancy legislation which has been developed to protect retail tenants, especially smaller specialty tenants. Generally, the parties cannot contract out of that legislation.

A summary of the key features and usual terms of office and retail leases (subject to retail lease legislation) in Australia is set out below, indicating the key differences between the two types of leases.

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LEASE TERM	OFFICE LEASE	RETAIL LEASE (SUBJECT TO RETAIL LEASE LEGISLATION)
<b>Duration</b>	Freely negotiable 3 to 5 years common for smaller tenancies 10 years or more not unusual for major tenants	Minimum length 5 years, except in QLD
<b>Payment of rent</b>	Monthly	Monthly
<b>Rent review</b>	Annual increases, usually by fixed percentage or consumer price index (CPI) Market review common on lease renewal Upwards-only rent reviews common, although cap and collar provisions not unusual	Similar to office leases. Turnover rent may also be payable  Upwards-only market rent review clauses generally unenforceable
<b>Outgoings recovery</b>	Recovery of all outgoings ("Triple-net") uncommon – structural and capital costs generally excluded Other costs, including insurance, usually recoverable	Often gross rent payable (the rent payable includes an amount for outgoings) Certain outgoings not recoverable, e.g. land tax not recoverable and a cap on increases in management fees applies
<b>Repair</b>	Tenant usually responsible for maintenance and repair of interior of premises Landlord responsible for structural and capital costs usually excluded	Landlord's repair obligations wider, e.g. responsible for maintaining structure and fixtures and plant and equipment relating to services; compensation sometimes payable
<b>Insurance</b>	Landlord insures the building and recovers cost as outgoing Tenant insurances generally include public liability and tenant's property	Same as office lease
<b>Assignment / subletting</b>	Usually permitted with landlord's consent and subject to conditions Original tenant usually retains liability following assignment	Grounds upon which landlord may withhold consent generally limited Original tenant generally released from liability following assignment, on compliance with procedural requirements
<b>Change in control</b>	Landlord consent generally required, unless the tenant is listed	Same as office lease
<b>GST</b>	GST payable on rent Tenant generally required to gross-up rent payments to include GST – this must be expressed in the lease	Same as office lease
<b>Renewal right</b>	Freely negotiable No general implied right	No general implied right, but landlord usually has notification obligations
<b>Security</b>	Bank guarantee for 3-12 months' gross rent common, depending on tenant covenant strength Security bond less common	Same as office lease

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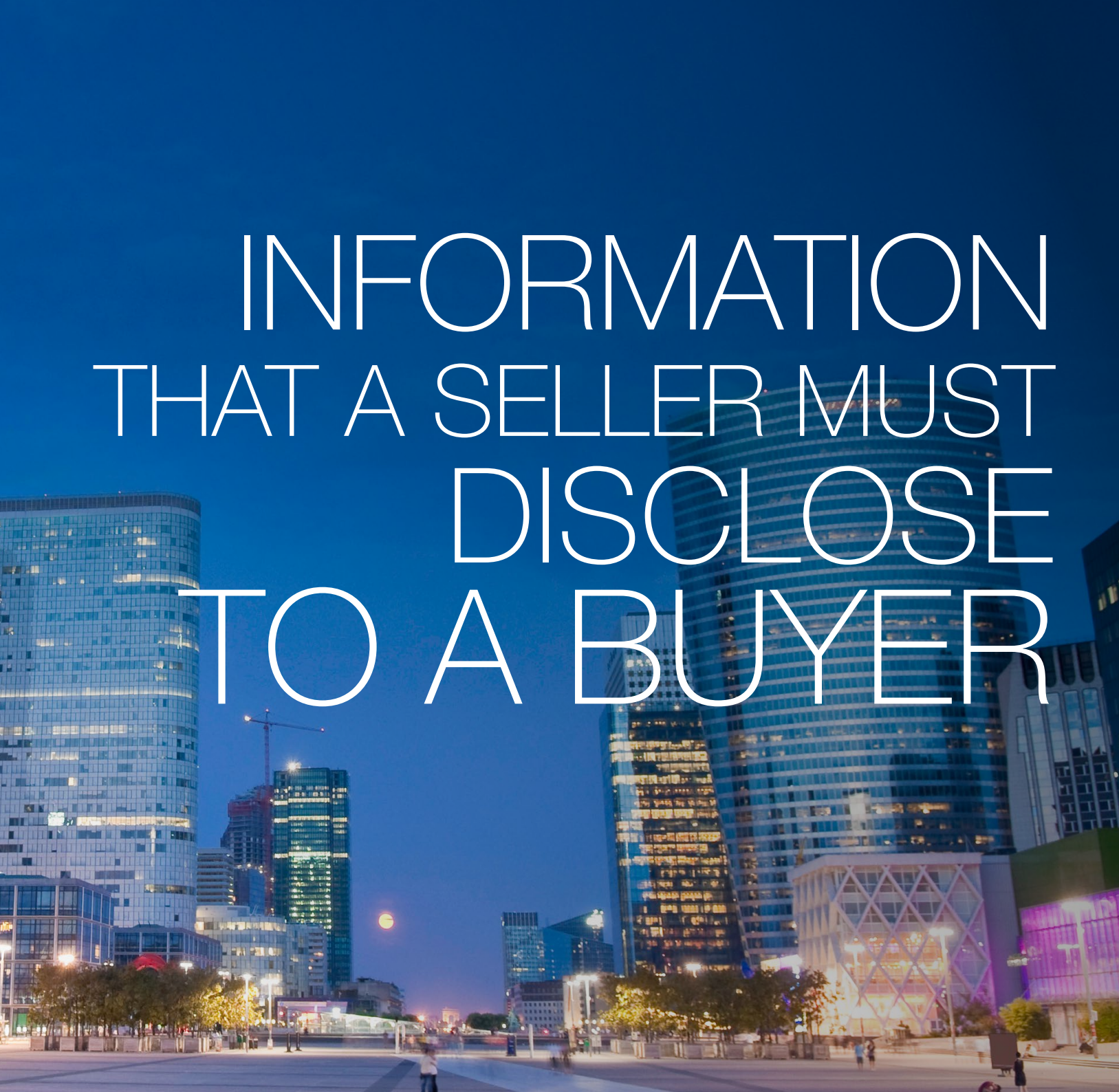
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# INFORMATION THAT A SELLER MUST DISCLOSE TO A BUYER

In real estate transactions, the general rule is caveat emptor or buyer beware

## **BUYER BEWARE**

Accordingly, the buyer must carry out and rely on its own due diligence with regard to the physical condition of the target asset and other matters affecting the value of the buyer's proposed investment.

From a legal perspective, a due diligence would usually involve:

- a title review, to verify good marketable title
- an occupancy review, to verify net income and assess any impact on the investment value
- a planning review, to confirm the current use of the target asset complies with the planning scheme
- a review of environmental registers maintained in the various jurisdictions, and any environmental reports in respect of the target asset, to ascertain any environmental liabilities relating to the target asset
- a review of service contracts and other arrangements that may affect the target asset after settlement

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- a litigation review, to identify any litigation affecting the target asset or the entities in the structure that holds the target asset
- a corporate review of the entities in the structure, including for compliance with Corporations Act requirements, if the acquisition is of an interest in a corporate or trust structure that holds the target asset
- a taxation due diligence on the entities in the structure, if the acquisition is of an interest in a corporate or trust structure that holds the target asset, to identify any taxation liabilities and confirm compliance with taxation reporting and return requirements.

The seller will assist the buyer in its due diligence by making disclosure of relevant documents, including copies of all current leases, service agreements and licences.

## LEGISLATIVE DISCLOSURE OBLIGATIONS

Most states and territories have in place legislative regimes requiring the seller to disclose specified matters to the buyer which might impact on the title to the target asset or its use and enjoyment. The sort of information which a seller is required to disclose usually includes information on the title and other information available from statutory or local authorities showing, for example, information such as land tax, municipal and water rates and planning scheme details.

If the seller supplies false information, or fails to supply all required information, the buyer may be entitled to rescind the contract for the sale and purchaser of the target asset.

If the seller does so knowingly, or recklessly, it may also be exposed to a civil penalty.

Consumer protection premised legislation also makes it an offence for the seller to engage in misleading or deceptive conduct or make a false or misleading misrepresentation in connection with the sale of an interest in land. Silence can be sufficient to establish misrepresentation, if it would

lead a reasonable person to believe that a particular state of affairs exists when it does not. If the buyer suffers loss arising from the misrepresentation, it is entitled to recover compensation for the amount of the loss. A pecuniary penalty may also be imposed on the seller.

## OTHER DUE DILIGENCE

Aside from legal due diligence, a buyer will also usually engage:

- a valuer to advise on the valuation of the target asset
- a technical due diligence consultant, to review the physical condition of the target asset and its services and compliance with relevant building regulations and code requirements
- a surveyor, to assess whether the target asset (including any buildings is located within the title boundary)
- an environmental due diligence consultant, to assess whether (including any buildings) are likely to be contaminated or contain hazardous substances
- if the acquisition is of an interest in a corporate or trust structure that holds the target asset, an accountant to review the accounts of the entities in the structure.



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# LIABILITIES A BUYER ASSUMES ON A DIRECT REAL ESTATE ACQUISITION

## General and Environmental Liabilities

### GENERAL LIABILITIES

Generally, on transfer of ownership, the buyer will assume liability for matters relating to the target asset, such as liabilities under leases.

The contract would often provide for the seller to retain responsibility for pre-completion liabilities, and the buyer to assume responsibility and indemnify the seller for post-completion liabilities. Sometimes a buyer will want to take over the service contracts that relate to the target asset which would usually require a novation of those service contracts.

The buyer would usually seek to protect itself by obtaining contractual warranties from the seller in respect of specific risks that cannot be confirmed or quantified during due diligence.

It is increasingly common for parties to take out warranty and indemnity insurance to protect against the risk of breach of a warranty or claim under an indemnity given by the seller. The effect of such policies is to transfer the risk of loss in connection with the breach of warranty or indemnity from the seller to the insurer. While the policy can be taken out by the buyer or the seller, the majority of these policies are taken out by the buyer so that it has direct recourse to the insurer in the event of a breach of warranty. The obligation for the payment of premiums in

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connection with the policy can be a matter for commercial negotiation and is often dealt with in the contract.

## ENVIRONMENTAL LIABILITIES

Liability for environmental matters, such as contamination and pollution, is important given the potentially significant costs of clean-up and remediation.

All states and territories in Australia have environmental legislation addressing pollution and contamination. The relevant Environment Protection Authority is generally able to serve clean-up and remediation notices either on the original polluter or the land owner or occupier. A land owner may also be liable to others including adjacent land owners if contamination migrates from its site to other sites or nearby watercourses. Liability may exist even though at the relevant time the operations were lawful and had the approval of the environmental authorities.

This means that a land owner can be liable for contamination that predates its period of ownership. For that reason, it is important to make sure that specific risks and liabilities are assessed during due diligence and a suitable risk allocation is reflected in the contract.



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# PLANNING AND ENVIRONMENTAL REGULATION

## Planning Heritage, Native Title and Environmental Regulations

### PLANNING REGULATION

#### Planning controls

Control of land use is heavily regulated through statutory planning instruments. Each State and Territory has its own system of zoning land which designates permissible and prohibited uses. The planning instruments are extensive, covering not only permissible land uses but also design limitations, height controls, impacts on native vegetation, impact of other natural hazards and heritage, amongst other matters.

#### Planning approvals

Under the various state planning instruments, most land uses and developments will need to obtain planning approvals. Approvals are most often granted by the local council, or for some larger projects can be granted by the state government. The planning approvals can be very detailed and include conditions governing the time within which the building or parts of the building are to be completed, built form, hours of operations, amenity impacts and payment to the authorities of development contributions. In a due diligence, investors should ensure that the properties being considered have obtained the relevant planning approvals as without them there is a risk that the use may not be permitted to

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continue, or building works may need to be rectified or demolished. Investors should also inform themselves during a due diligence process of any planning controls or conditions on planning approvals which may limit future expansion of existing premises.

Any proposed new development (including modifications to approved development) will be required to undergo an assessment process under the planning and/or environmental legislation of the relevant state. There are generally appeal rights to state courts in relation to decisions arising out of the assessment process. In some instances, appeals can be lodged by third parties. Obtaining approvals can take some time, although there is sometimes a streamlined process available for major projects.

## ENVIRONMENTAL REGULATION

### Commonwealth requirements

The main piece of Commonwealth environmental legislation is the Environmental Protection and Biodiversity Conservation Act 1999 which regulates actions that have or are likely to have a significant impact on one of the following: world heritage properties; national heritage places; wetlands of international importance; listed threatened species and ecological communities; migratory species protected under international agreements; Commonwealth marine areas; the Great Barrier Reef marine park; nuclear actions (including uranium mines) a water resource, in relation to coal seam gas development and large coal mining development, and actions that will affect the land owned by the Commonwealth.

In these cases, an additional approval is required from the Commonwealth government. Carrying out activities without a required approval is a serious offence.

Overall, the majority of environmental regulation in Australia is carried out at state government level, as set out below.

## Environmental licences

State-based environmental protection legislation requires that specified activities that have adverse environmental impacts will require a licence. Penalties apply for not complying with an environmental licence. Licences are most often related to management of waste and industrial type premises but can include other premises which are deemed to have an impact on the environment. These licences will govern many aspects of environmental regulation at a site and generally require annual fees, pollution prevention and monitoring, ongoing monitoring of emissions and annual reporting. Investors will need to ensure that any necessary licences are obtained, or the premises will not be able to operate. There are statutory provisions that deal with transferring an environmental licence to a new holder.

### Offences

Under State and Territory environment protection legislation, it is an offence to pollute air, water, or land without a licence. Most of these offences are strict liability, meaning that there are very limited defences. Pollution incidents are often prosecuted by the Environment Protection Authority (EPA) resulting in fines and restitution orders, and more rarely imprisonment.

In criminal proceedings for certain offences (such as a breach of licence conditions or pollution of the environment) directors can have personal liability. These provisions do not apply if the director can show he/she was not in a position to influence the conduct of the corporation in relation to its contravention of the law, or if the director was in a position of influence, he/she used all due diligence to prevent the contravention. In our experience, environmental non-compliances of the kind listed above are not ordinarily prosecuted provided there is little or no environmental harm and actions are taken to address the non-compliance.

## Contamination

Certain levels of soil and groundwater contamination will require notification to the EPA. Each state's EPA can also order clean-up of contaminated sites. Typically, the EPA will order the original polluter or the current owner of a site to carry out clean-up. That owner may then seek to bring court proceedings to recover the clean-up costs against the original polluter, assuming the original polluter can be found. There may be issues, however, where it is impractical or impossible to attribute liability to the actual polluter or where the polluter cannot be found. In these cases, responsibility can fall back to the current owners or occupiers of the site. Clean-up of contaminated sites and groundwater can run into millions of dollars. A polluter will always remain responsible under each of the State regimes for its contamination, including any contamination that the person or company had caused on sites it has now vacated or sold. However, there are contractual ways to deal with the issue of contamination. It is important to make sure that specific risks and liabilities are assessed during due diligence and a suitable risk allocation reflected in the contract.

Contractual options available for a purchaser to deal with the issue of liability for any contamination include, for example, an allowance in price for the estimated clean-up costs or indemnities whereby the vendor indemnifies and releases the purchaser from pre-existing contamination.

If you do not wish to accept full liability for any potential contamination, you can do one or more of the following:

- have an environmental assessment undertaken by your environmental consultants before exchange or completion of the sale in order to ascertain the full baseline position as at the sale date
- capping liability for contamination by one party at an agreed amount

- holding back part of the sale proceeds to fund remediation.

In our opinion, the option you take will depend on a range of commercial factors, including whether the purchase price already includes an allowance for any potential unquantifiable clean-up costs, whether you are willing to take on the risk that the property is contaminated, and whether you have plans for future redevelopment of the property.

### Water

Ensuring security of water supply can be a critical for large water users, particularly in regional and rural Australia. It is unlikely to be an issue in city sites. However, it will be significant in the expanding area of agribusiness. Licences for water supply will be required in some circumstances. These are issued under heavily regulated schemes for water allocation and systems for trading water.

## NATIVE TITLE

### Existence of native title rights

In Australia, the rights and interests of indigenous inhabitants in their traditional land, in accordance with their own laws and customs, are protected at common law and under legislation. These rights are referred to as "native title".

To date, there have only been a small number of native title claims that have been determined by the Federal Court to hold native title, however there is a large number of native title claims that have been registered by the National Native Title Tribunal and attract native title procedural rights.

### Extinguishment of native title rights

Native title is extinguished if an inconsistent grant of an interest in the land to people other than the native title holders was granted prior to 23 December 1996. Such grants include the grant of freehold land and most forms of leases. It is also possible for native title to be extinguished in the same manner after

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23 December 1996 if the procedures in the Native Title Act are followed.

This means that native title will not always be an issue on investment in Australian real estate – it will depend upon the real estate in question and title to it. It is relatively unusual for native title to be an issue on city-centre sites, such as office buildings. However, in the expanding area of agribusiness, involving large tracts of undeveloped land, the potential for native title claims to arise must be considered.

## HERITAGE

Heritage, both natural, indigenous and historic, needs to be considered during due diligence of a proposed investment in Australian real estate.

There is legislative protection of items of Australian heritage. Where real estate is listed on a heritage register or otherwise affected, restrictions may be placed on any development which would affect the heritage items.

Specific indigenous heritage legislation exists to protect sites and objects of significance to indigenous people. Indigenous heritage sites may exist on land that is not the subject of native title. Consent of the relevant Minister may be required if use of the land may disturb or destroy Aboriginal sites. The Commonwealth legislation provides for emergency (and permanent) declarations in the event that state legislation fails to protect a significant Aboriginal site.



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# HOW SUSTAINABILITY IMPACTS REALESTATE

## Sustainability is a Huge Focus in Today's Market

### **SUSTAINABILITY AND ENERGY EFFICIENCY**

#### **Reporting requirements**

The National Greenhouse and Energy Reporting Act 2007 (Cth) introduced a mandatory reporting scheme known as NGERs which requires the controlling corporation to register and report on greenhouse gas emissions, energy production and energy consumption from the operation of facilities under the operational control of members of the group, if certain thresholds are met.

The controlling corporation is the top Australian holding company in the group. Operational control is determined by the authority to introduce and implement operating policies, health and safety policies or environmental policies for the facility. A facility is an activity or series of activities which involves the production of greenhouse gas emissions, the production of energy or the consumption of energy and forms a single undertaking or enterprise.

A range of commercial, industrial and retail sites could fall within this definition.

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## Rating and assessment

There are two voluntary schemes in place that assist a building owner to promote the environmental performance of its buildings:

### NABERS

The National Australian Built Environment Rating System (**NABERS**) is a rating scheme which assesses a building's measured operational impacts on the environment and provides an indication of how well a building's environmental impacts are being managed in comparison to its neighbours. The rated building is assigned a certain number of stars ranging from zero to six based on its performance in the categories of energy, waste, water and indoor environment.

Commercial leases in Australia, at least of new premises and major tenants, often contain commitments by a landlord in respect of the NABERS rating to be achieved. The federal government and most State and

Territory governments have accommodation policies that require tenancies occupied by government employees to have a minimum NABERS rating, which has encouraged voluntary adoption of the rating.

For this reason, in an area like the Australian Capital Territory where the federal government occupies a lot of accommodation, the absence of the minimum required NABERS rating significantly impacts the value of a building.

### Green Star

The Green Star program assesses a building's potential to reduce its environmental impact. Each category (such as energy, water and emissions) is divided into credits, with points awarded in each credit for actions that demonstrate the project has met the overall objectives of Green Star. The ratings awarded range from 1 star to 6 stars. Only buildings that achieve a rating of 4 or more stars will be

certified by the Green Building Council and are able to use the Green Star trademark.

The Green Star program is administered by the Green Building Council of Australia (GBCA). The GBCA underwent a review of the Green Star rating system in the first half of 2019 and has raised the rating criteria to assist Australia meet its obligations under the Paris Climate Agreement.

### Disclosure requirements

The Building Energy Efficiency Act 2010 (Cth) imposes mandatory disclosure obligations on landlords and sellers in respect of the energy efficiency ratings of commercial buildings (if at least 75% of the net lettable area of the building is for administrative, clerical, professional or similar information-based activities). It provides for certain information on energy efficiency, including a NABERS rating, to be disclosed in the form of a Building Energy Efficiency Certificate (**BEEC**).

A valid and current BEEC is required to be provided before a contract or lease can be entered into, and even before the property may be marketed for sale or lease.

Buildings and office space with a net lettable area of less than 1,000m<sup>2</sup> are currently exempt from the disclosure requirements, as are buildings held under a strata title system, new buildings, and buildings which have completed a major refurbishment, with certificates of occupancy issued in not more than the previous 2 years. Certain other limited exceptions also exist, including if any proposed lease is for 12 months or less.

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# PROPTech BECOMES INVESTABLE

## INVESTING IN PROPTech

The digital transformation of our society is having a profound effect on the way that we design, build and use space. As a result, technology (and more specifically 'PropTech') has become an accepted element of strategy in the real estate sector in Australia with dedicated technology, innovation and PropTech platforms now core sector participants.

PropTech has rapidly become a part of a broader digital transformation driving change in the real estate sector. The current market cycle has seen advancement in data capture and analysis to make physical space more interchangeable, and, when coupled with the shared economy thematic, has resulted in disruptors such as WeWork and Airbnb becoming mainstream.

Innovation and new technologies are now driving efficiencies through the digitisation of process and enabling of the collection and analysis of more data than ever before. Which in turn is bringing informed new perspectives to the design of healthy and flexible living and work spaces. Those spaces are being constructed using new building methods such as 3D printing and multifunctional paint, and then managed using smart building automation and smart contracts. New ways of funding are then making funding (in what has historically been a highly capital-intensive sector) more feasible and making bricks and mortar more liquid than we have previously seen.

This adoption of new technologies has been transformative to the culture of the real estate sector. While venture capital has not always been interested in real estate, the current cycle has seen the amount of venture capital invested in PropTech increase significantly resulting in what was once a predominantly residue focussed sector, founded on personal relationships and a portfolio management approach premised in the long-term being displaced by rapid technological innovation, data analytics and new types of customer interface and engagement. That said, real estate related technology investment still accounts for only a relatively small proportion of total venture capital investment.

Looking forward, the opportunity for technology and innovation enabled participants in the sector is not only the scale of the market<sup>12</sup>, but also by the limited relatively low levels of investment (and innovation) in real estate related technology to date. Historically, real estate sector participants have been restrained in their commitment to technology related investment and been reluctant in their exposure to start-up platforms. In contrast to other sectors and industries which have a track record for investment in technology, the real estate sector remains relatively under invested.

12. According to certain data collected by JLL, the total value of investable commercial real estate globally is expected to be in the region of US\$65 trillion by 2020

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# INTELLECTUAL PROPERTY ISSUES AFFECTING AUSTRALIAN REAL ESTATE

## Protecting Building and Business Names

### BRANDING – TRADE MARK RIGHTS AND PROPERTY DEVELOPMENTS

Trade marks can be registered in Australia under the Trade Marks Act 1995 (Cth) (**Trade Marks Act**). Trade marks can be obtained for, among other things, names and logos, which are often used in the promotion of retail shopping centres, hospitality assets and strata-titled buildings (including holiday accommodation).

Registration of a trade mark confers rights on the trade mark owner to prevent others from using the same or similar logo for the products or services for which the trade mark is registered. Whilst geographic names cannot be registered, it is possible to obtain trade mark protection for building names where those names are used in connection with businesses associated with a building.

Recent Australian court cases demonstrate that owners of management and letting rights in a strata-titled building, who also own the trademarks containing the building name, can enforce those trade marks against offsite accommodation providers, even though the trade marks for the letting business are the same as the name of the building.

Where buildings are co-owned, consideration should also be given to the implications of the ownership structure for branding. Joint ownership of trademarks is permissible under

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the Trade Marks Act, so one option is for the co-owners of the real estate to also own any registered trade marks rather than having a single owner such as a building manager.

## BUSINESS NAMES

Business names legislation in Australia requires traders who carry on business under a name that is not the same as the trader's own name to register that name as a business name. This is largely to allow people who deal with that business to find out who is actually carrying on the business in case they need to take action against the business operator. A registered business name is not a form of property that can be bought or sold, but is transferred when the underlying business is sold. In terms of real estate, this means that the business name given to, for instance, a

hotel or some retail centres usually needs to be registered.

## COPYRIGHT IN BUILDING PLANS AND ARCHITECTURAL DRAWINGS

Copyright protects building plans and architectural drawings. Reproduction of such plans and drawings without the permission of the copyright owner (either express or implied) will generally infringe copyright law. There will usually be an implied licence to use building plans and architectural drawings for contemplated purposes (such as to obtain planning approval and have the development constructed). However, a developer should always negotiate copyright ownership or at least clear licence rights. A buyer should always check whether licences to use building plans and architectural drawings

are transferable on sale, in case the original building plans or drawings are needed later for refurbishments of the real estate asset. In some cases, the designer's contract will stipulate that licences cannot be transferred without the payment of a fee.

Individual designers of building plans and architectural drawings also have moral rights, which continue to exist as long as the copyright exists. Moral rights include the right to be attributed as the creator of the plans or buildings, the right not to have the plans or buildings falsely attributed to another person or to be attributed to plans or buildings that have been altered without consent, and the right not to have the plans or buildings treated in a derogatory manner. For example, an architect may sue a building owner if

the building owner demolishes or alters any structure of the building arising from his or her plans in such a way that is prejudicial to the designer's "honour or reputation". Moral rights may be waived, so if it is likely that the plans or buildings may need to be altered in the future it would be prudent to secure a reasonable moral rights waiver from the designer. Where such waiver is not obtained, special exemptions may nonetheless apply in cases where the building owner wishes to demolish or alter a building but cannot discover the identity of the designer after making reasonable inquiries, or, if the designer is known, complies with a prescribed notice and consultation process, or where restoration or preservation of a building is done in good faith.

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## Abbreviated terms in This Guide

ACCC	Australian Competition & Consumer Commission
AFSL	Australian Financial Services Licence
ASIC	Australian Securities & Investments Commission
ASX	Australian Securities Exchange
BEEC	Building Energy Efficiency Certificate
CPI	Consumer Price Index
EOI	Exchange of Information
EPA	Environment Protection Authority
FATA	Foreign Acquisitions & Takeovers Act
FIRB	Foreign Investment Review Board
FSA	Financial Services Authority
GST	Goods & Services Tax
LVR	Loan to Value Ratio
MAS	Monetary Authority of Singapore
MIS	Managed Investment Scheme
MIT	Managed Investment Trust
NABERS	National Australian Built Environment Rating System
NGERS	National Greenhouse & Energy Reporting Scheme
PPSA	Personal Property Securities Act
RE	Responsible Entity
REIT	Real Estate Investment Trust
SEC	Securities & Exchange Commission
SFC	Securities & Futures Commission
TFN	Tax File Number

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