REAL ESTATE INVESTMENT IN AUSTRALIA

DLA PIPER

CONTENTS

FOREWORD 5

OVERVIEW OF THE AUSTRALIAN LEGAL SYSTEM 6

PURCHASE AND SALE OF REAL ESTATE 7

- Forms of ownership 8
- Regulation of foreign investment 8
- Investing in Australian businesses 9
- Investing in Australian real estate 9
- Other FIRB matters 10
- Process 10
- The contract 10
- Due diligence 11
- Title insurance 13
- Closing and registration 13
- Financing of commercial real estate 13

TAXATION OF REAL ESTATE INVESTMENTS 14

- Overview of the Australian taxation system 15
- Tax benefits of owning Australian real property 16
- Types of entities 17
- Importance of treaties 18
- Investment through loans 18
- Taxation of equity investments 18
- Direct equity investment 19
- Equity investment through an Australian corporation 19
- Equity investment through a foreign corporation 19
- Equity investment through an Australian partnership 19
- Equity investment through an Australian Managed Investment Trust 20
- Goods and services tax 20
- State and local tax considerations 22

INVESTMENT VEHICLES 24

- Key selection considerations 25
- Types of corporate entities 25

LEASES 28

- Understanding leases 29
- Commercial leases 29
- Residential leases 29
- Registration 29
- Basic terms of commercial leases 29
- Additional concepts in commercial leases 30
- Retail leases 31

CONSTRUCTION 32

- Contracts 33
- Infrastructure in Australia 33
- Obligatory requirements 33
- Liability 34
- Insurance 35
- Security of payment 35
- Handling disputes 36

ENVIRONMENTAL REGULATION AND DEVELOPMENT APPROVAL 37

- Planning laws 38
- Heritage 38
- Environmental laws 38
- Climate change policy and regulation 39
- Energy efficiency and green buildings 39

REAL ESTATE FINANCING 40

- Financing terms 41
- Security 41
- Mezzanine finance 41

USEFUL SITES 43

FOREWORD

Australia continues to be viewed as a destination of choice for global real estate investors seeking a safe haven in a well-regulated and highly transparent growth-orientated market for doing business. In addition, the Australian real estate market remains favourably priced when compared to other developed core real estate markets in the United States and Europe.

Whilst real estate markets globally were severely affected by the Global Financial Crisis and the economic turmoil that followed, Australia has performed well across most sectors and is widely viewed as a stable market offering discerning foreign investors historically favourable pricing. Compared to many of their home markets, Australia offers investors exposure to one of the few economies, globally, to be on a growth trajectory. This recognition has led to an increasing number of new foreign investors entering the Australian real estate market, to the point that foreign-sourced capital is now the dominant source for Australian real estate investment.

As a well-regulated, stable and transparent market, Australia offers a platform that allows new foreign investors to embrace the globalisation of real estate capital with confidence.

As global capital is shifting with even more speed and volume between sectors and markets, we at DLA Piper are where our clients want to be.

This legal guide demonstrates our commitment to ensure international clients have access to the intellectual property, seamless service, global perspective and local market knowledge of our unique international Real Estate Group.

As with all markets, investors must have access to reliable and easy to understand sources of information. This guide is specifically designed to assist foreign investors in gaining a quick understanding of the laws and practices associated with investing in Australian real estate.

Les Koltai
Head of Real Estate, Australia
DLA Piper

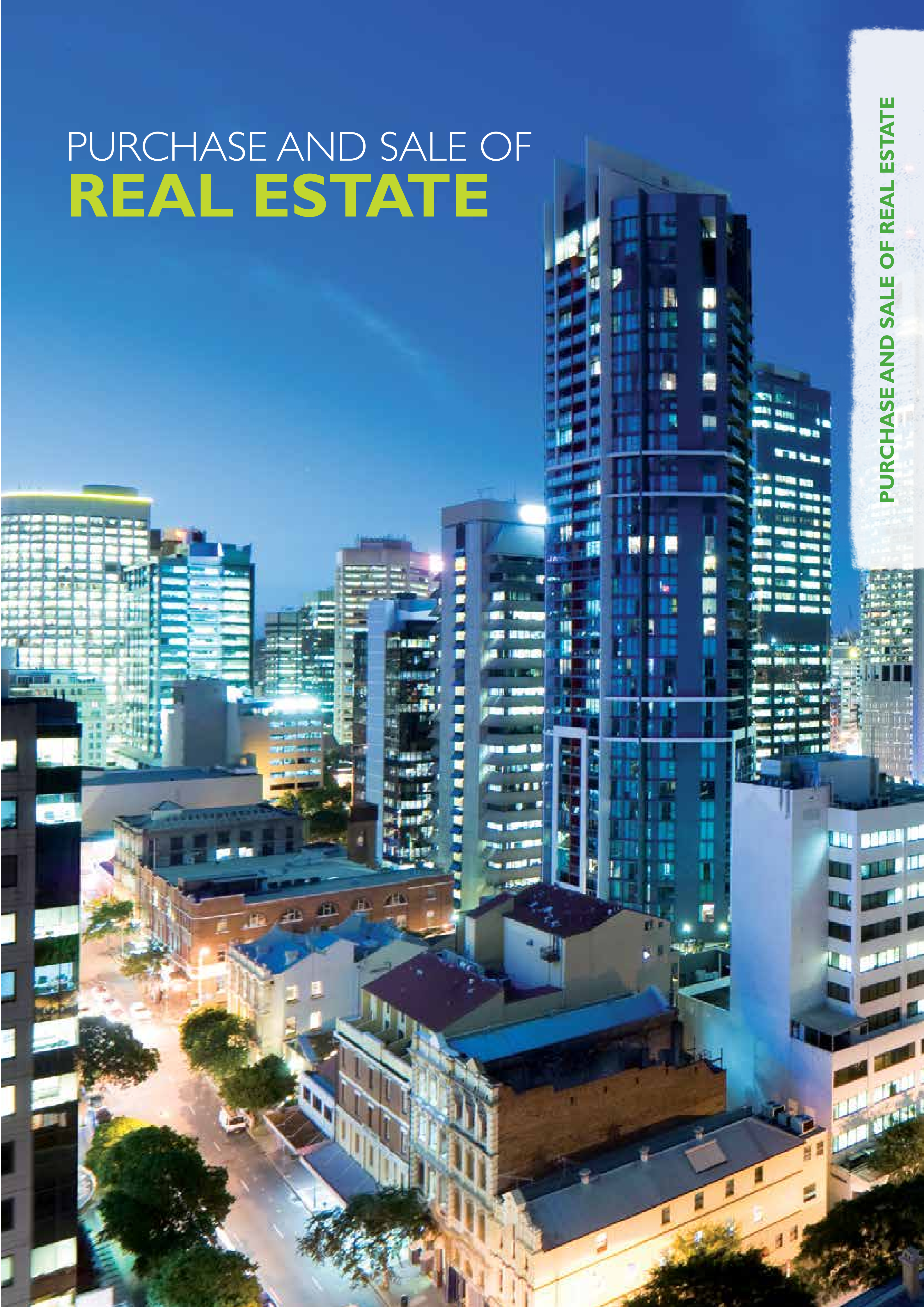
OVERVIEW OF THE **AUSTRALIAN** LEGAL SYSTEM

Australia's legal system is a common law system, similar to that of Britain. Federal Parliament may pass statutes and make regulations under statutes to deal with specific issues. This is subordinate legislation and must be tabled in parliament. A body of common law is developed and interpreted by a judiciary, which also has the role of interpreting statutes and regulations.

Courts are operated at federal and state levels. Judges are appointed by federal and state governments and serve until retirement age unless removed for misconduct. A comprehensive appeals system exists at both levels.

Australia's legal profession is modelled on the British system and most states distinguish between barristers, who mainly appear in court, and solicitors, who are professionals authorised to practice law, conduct lawsuits and give legal advice to the clients.

PURCHASE AND SALE OF **REAL ESTATE**



FORMS OF OWNERSHIP

Throughout Australia, there are two principal legal structures in which real estate is directly owned: freehold title and Crown leasehold title. Owners of freehold title benefit from the absolute ownership of their land for an indefinite period of time. A Crown leasehold title confers rights of exclusive possession and use, pursuant to specific legislation. Some Crown leasehold titles are perpetual in nature and others are granted for fixed periods of time.

Both freehold title and Crown leasehold title are subject to government powers of resumption, applicable laws governing the manner of use of their property (such as building regulations and town planning laws) and contractual arrangements freely bargained for by the holder of the title.

Owners of freehold title and Crown leasehold title are able to grant leases of the property to third parties.

We examine the process of transferring title to real property in the rest of this chapter. The key features of leases are examined in the Leases chapter.

REGULATION OF FOREIGN INVESTMENT

While there are some restrictions on foreign investment generally, the Australian Government (Government) recognises that foreign real estate investment can enhance Australia economically and socially. Accordingly, Australia's foreign investment regime is premised on ensuring foreign investment is consistent with Australia's national interest.

Foreign investment policy in Australia is regulated by the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (FATA), the *Foreign Acquisitions and Takeovers Regulations 1989* (Cth) and other requirements set out by Ministerial Statement. FATA and its related regulations allow the Government to scrutinise proposed purchases by foreign persons of shares in companies incorporated or having assets in Australia and Australian real estate.

The FATA regime is administered by the Federal Treasurer and the Foreign Investment Review Board (FIRB). FIRB is a non-statutory advisory body that examines foreign investment proposals, advises the Treasurer on whether the proposals are compliant with Australia's foreign investment policy and assists foreign investors in ensuring their proposals comply with government policy.

Foreign investment may also be regulated under other federal, state and territory laws. For instance, state or local government approvals may be required for development projects involving construction works. While these regulatory regimes vary depending on state and/or industry sensitivities, restrictions are normally applicable to the mining, gambling, insurance and liquor industries. Professional advice should be sought and any restrictions carefully considered before deciding to invest in these areas.

Foreign persons

A foreign person includes:

- A person not ordinarily resident in Australia
- A corporation in which a person not ordinarily resident in Australia (non-resident) or a foreign corporation holds a controlling interest (15% or more)
- A corporation in which two or more non-residents or a foreign corporation hold an aggregate controlling interest (40% or more)
- The trustee of a trust estate in which a non-resident or a foreign corporation holds a substantial interest
- The trustee of a trust estate in which two or more non-residents or a foreign corporation holds a substantial interest. A substantial interest in a trust estate arises when the trustee of the trust is empowered to distribute to a foreign person, either alone or together with associates, more than 15% of the income of the trust estate.

A substantial foreign interest occurs when a single foreigner (and any associates) has 15% or more of the ownership or several foreigners (and any associates) have 40% or more in aggregate of the ownership of any corporation, business or trust.

General requirements for foreign investment

Under the FATA regime, the key criterion for approval is whether or not the investment is considered "contrary to the national interest". The general presumption is that foreign investment proposals will serve the national interest. The Treasurer has wide powers to prohibit foreign investment proposals and to order divestiture or unwinding of foreign investment proposals or unwinding of foreign investment arrangements in Australian companies and businesses if they are considered to be contrary to national interest.

The Treasurer determines what is contrary to national interest by considering the widely held community concerns of Australians. The Government policy is to balance these concerns against the strong economic benefits for Australia that arise from foreign investment. National interest implications are determined on a case-by-case basis. Notification of the proposal to FIRB requires the submission of certain information required under FATA regarding the acquirer and the proposal. FIRB issues guidelines to assist with clarifying obligations under FATA.

Approval may be granted by the Treasurer subject to the acquirer and the proposal meeting certain conditions (for instance, timeframes for completion of development activities or environmental requirements). More recently, conditions are also increasingly imposed on acquisitions by state-owned enterprises and sovereign wealth funds.

Broadly, reporting requirements associated with foreign investment proposals can be divided into two categories: firstly, those which are subject to compulsory notification; and secondly, proposals which are at or above the annually indexed monetary thresholds that exist for notifying FIRB of individual investment proposals.

US and New Zealand investors

Separate monetary thresholds are applicable for United States investors under the Australia-United States Free Trade Agreement (AUSFTA), and for New Zealand Investors under the Protocol on Investment to the Australia – New Zealand Closer Economic Relations Trade Agreement (ANZCERTA).

US investors are defined as nationals or permanent residents of the US; a US enterprise (constituted or incorporated under US law); or a branch of an entity located in the US and carrying on business activities in the US.

New Zealand investors are defined as citizens, nationals or permanent residents of New Zealand; a New Zealand enterprise (constituted or organised under a law of New Zealand); or a branch of an entity located in New Zealand and carrying on business activities in New Zealand.

Importantly, the definition of US/New Zealand enterprise excludes an Australian entity (such as an Australian subsidiary established as an Australian vehicle) owned by a US/New Zealand enterprise. Proposed acquisitions by such entities therefore continue to be subject to the standard thresholds applicable to non-US investors and non-New Zealand investors.

INVESTING IN AUSTRALIAN BUSINESSES

Notification of proposals

Non-real estate acquisitions of less than AU$248 million are generally exempt from compulsory notification. Proposals currently requiring approval include:

- Acquisitions of substantial interests in existing Australian businesses (including agribusinesses) whose gross assets exceed AU$248 million or where the proposal values the business at over AU$248 million.
- All investments in the media of 5% or more, irrespective of value
- Takeovers of offshore companies whose Australian subsidiaries or gross assets are valued at AU$248 million or more, or the applicable US investor threshold of either AU$1,078 million or AU$248 million for prescribed sensitive sectors
- Direct investments by foreign governments or their agencies, including sovereign wealth funds, irrespective of size.

For US and New Zealand investors, notification threshold of AU$1078 million, except for investments in prescribed sensitive sectors (including media, telecommunications, transport, human resources services, defence services or supplies, extraction of uranium or plutonium or the operation of nuclear facilities), which are subject to the standard AU$248 million threshold.

When considering whether a proposed investment is notifiable, funding arrangements (including debt instruments) having quasi-equity characteristics are treated as direct foreign investment.

Investors in sensitive sectors such as banking, telecommunications, shipping, subject to more detailed examination, but are approved unless considered contrary to the national interest.

The Government recommends that where any doubt exists as to whether a proposal is notifiable to FIRB, it should be notified.

INVESTING IN AUSTRALIAN REAL ESTATE

Australian urban land

Australian urban land includes all land situated in Australia that is not used exclusively for carrying on a substantial business of primary production. Therefore, land that is not used for commercial farming or forestry purposes (accounting for detailed inclusions and exclusions if relevant) will generally be considered urban land.

Proposals concerning urban land that require notification to FIRB include acquisitions of interest in urban land, including interests that arise through leases, financing and profit-sharing arrangements that involve the:

- Acquisition by a non-US/New Zealand investor of developed non-residential commercial real estate valued at AU$54 million or more, or if the property is subject to heritage listing, valued at AU$5 million or more
- Acquisition by a US/New Zealand investor of developed non-residential commercial real estate, where the property is valued at AU$1,078 million or more.

Proposed acquisitions of real estate for commercial development (not to be used for residential purposes) are generally approved subject to development conditions under FATA, being continuous construction commencing within five years and a minimum amount being spend on the development, which is equivalent to the higher of 50% of the acquisition cost or current market value of the land.

Australian urban land corporations/trusts

A corporation or trust is deemed to be an urban land corporation or trust if it holds more than 50% of its assets in Australian urban land. Notification to FIRB is required if the value of its (and its subsidiaries) total Australian urban land assets exceeds 50% of the value of its total assets, irrespective of the total value of the company, trust or the value of the proposal.

Residential real estate

In its regulation of foreign investment in residential real estate, the Government seeks to increase the supply of residential dwellings and ensure that investment is not speculative in nature.

Residential real estate means all Australian urban land other than commercial real estate and rural properties used wholly and exclusively for carrying on a substantial business of primary production.

Any acquisition of residential real estate regardless of value requires notification to and approval by FIRB, unless an exemption applies.

Rural land

Australian rural land includes all land that is used wholly and exclusively for carrying on a business of primary production.

Proposed acquisitions of a business where the total assets of the business exceed $248 million (or $1,078 million for US/New Zealand investors) must be notified to FIRB and require approval.

Exemptions for real estate acquisitions

Generally, foreign buyers intending to acquire real estate in Australia must seek prior approval from the Government, unless specifically exempted as follows:

- Acquisitions by Australian citizens living abroad or by New Zealand citizens purchasing residential property
- Acquisitions by foreign nationals who hold a permanent resident visa or who are buying property as joint tenants with their Australian citizen spouse
- Acquisition of a new dwelling bought from a developer who has pre-approval to sell them to foreign persons
- Acquisition of an interest in a time share scheme that allows four weeks' use per year
- Acquisition of certain residential real estate in integrated tourism resorts
- Acquisition of an interest in developed commercial property where the property is to be used immediately and in its present state for industrial or commercial purposes, and the acquisition is wholly incidental to the purchaser's proposed or existing business activities

- Acquisition of an interest in developed commercial property valued below the relevant monetary thresholds discussed earlier
- An interest acquired by will or by operation of law
- An interest acquired from a government in Australia (Commonwealth, state, territory or local) or a statutory corporation formed for a public purpose.

Contractual arrangements

FATA stipulates that agreements involving foreign persons must be made conditional on approval.

Any contracts by foreign persons to acquire real estate in Australia must also be made conditional on FIRB approval (unless approval has already been granted). Contracts should provide for a minimum 40 days from the date of lodgement for a decision from FIRB.

For real estate to be purchased at auction, prior FIRB approval must be obtained.

OTHER FIRB MATTERS

Proposed investments by foreign governments and their agencies irrespective of the size of the proposal must be notified to FIRB. In examining foreign investment proposals by foreign governments and their agencies, FIRB will consider whether or not an:

- Investor's operations are independent of the relevant foreign government
- Investor is subject to and adheres to the law and observes common standards of business behaviour
- Investment may hinder competition or lead to undue concentration or control in the industry or sectors concerned
- Investment may impact on Government revenue or other policies (for instance, investments by foreign government entities must be taxed on the same basis as other commercial entities)
- Investment may impact on Australia's national security
- Investment may impact on the operations and directions of an Australian business as well as its contribution to the Australian economy and broader community.

PROCESS

FIRB's intention is to deal with proposals quickly and aims to provide a 30-day time frame for decisions. Once formally notified, the Federal Treasurer has 30 days to take action and a further 10 days to notify the parties concerned. Where FIRB is not able to meet the 30-day service standard, it has developed a practice of requesting a party to withdraw and resubmit their application to initiate a new 30-day review period.

Approval of proposals may be subject to parties meeting certain conditions, and the applicant and their advisers will be informed of the conditions prior to the Treasurer making the decision.

Approvals stand for one year. FIRB should be informed if the completion of a transaction will exceed this period. Additionally, a new application is expected where there are subsequent material departures from the existing approval.

All proposals must specify the particular property to be acquired as a general or in-principle approval is not available.

Commercial-in-confidence information is respected and appropriate security given to proposals submitted to FIRB. If a third party takes action to obtain access to the information, it will not be made available unless a court so orders. The Government will normally defend confidentiality through the courts.

Thresholds

The monetary thresholds for investment are subject to annual indexation and accordingly, the thresholds prevailing from year to year should be checked.

THE CONTRACT

There is no universally accepted form of real estate purchase agreement in Australia. Most states have pre-printed contracts endorsed by industry bodies and state law societies that can be useful for more straightforward transactions. However, in most transactions the parties negotiate a customised contract that reflects the specific transaction.

The parties often record the deal points initially in a non-binding letter of intent or term sheet, before commencing negotiation of the formal contract. These arrangements usually include confidentiality provisions and exclusivity periods.

The form of contract varies, depending in large part on whether the real property has buildings (known as "improved") or is vacant land (known as "unimproved"); whether the real property is intended for residential, commercial, industrial or mixed use; and whether the purchase price will be payable in cash or in some form of vendor financing.

Some important and typically contested issues in a contract include:

Property

The contract must properly describe the scope and nature of the property being transferred. The main asset is, of course, the real property and any related easements, lease rights or appurtenant rights (such as water or mineral rights), together with any improvements.

Any registered encumbrances over the real property (such as easements and restrictive covenants) should be fully disclosed in the contract.

Depending on factors such as whether the real property is improved or unimproved, the property being sold under the contract may also include personal property, trade names, intangible property and development agreements or other land use entitlements.

Purchase price

The purchase price is usually negotiated directly between the parties or their agents. Typically, any mortgages granted by the seller are discharged at closing. Goods and Services Tax (GST) consequences need to be considered by the parties up front and appropriate GST clauses included in the contract.

Deposit

The buyer normally pays a deposit of up to 10% of the purchase price upon formation of the contract. In the context of a contract that provides for a "due diligence" period in which the buyer may withdraw from the transaction, the deposit typically only becomes non-refundable to the buyer after the buyer has declined to terminate the contract at the end of the due diligence period. However, even after the due diligence period expiration, there are limited circumstances (such as the seller's default, destruction of the property or the failure of a condition precedent to closing) when the deposit will still be refunded to the buyer. The parties can provide for the deposit to be paid in instalments, often with one instalment payable at contract signing and a further instalment payable by the expiration of the due diligence period, or other significant conditions precedent to closing being satisfied. The deposit will be applied toward the purchase price due at the closing. The deposit is often used as an amount of liquidated damages that the seller is legally entitled to retain under the contract if the buyer fails to close the transaction in breach of its obligations.

The deposit is usually held in the trust account of a licensed real estate agent, or in the trust account of the seller's lawyers (or the buyer's lawyers in some instances). The parties can agree that the deposit holder is authorised to invest the deposit until closing, and how any interest accruing on the investment is to be apportioned between the parties.

Generally speaking, for larger commercial acquisitions, the due diligence process will occur usually during a pre-contract exclusivity period. To preserve confidentiality and to protect the seller's interest in the property, the seller may require the buyer to enter into a confidentiality agreement before the buyer is given access to due diligence materials in relation to the property. This agreement may also document the conditions under which the buyer is permitted to speak with any existing property manager, any tenants, government agencies or other third parties about the property and have access to the property to conduct physical inspections. The period allowed for in a pre-contract exclusivity period varies from the size and complexity of the transaction. It is also not unusual for the terms of the contract for sale to be negotiated in this period and the parties to agree to set milestones where an extended period of exclusivity is granted.

Representations, warranties and covenants

The parties must negotiate the scope of representations and warranties to be given by the seller to the buyer concerning the seller's ability to consummate the transaction, the condition of the property and any materially adverse issues affecting the property.

Especially for improved property with tenants, the seller normally covenants to operate the property in a manner consistent with standard past practice until completion. The buyer usually will accept the property in its "as is" condition, subject to any express representations, warranties and covenants in the contract.

Tenanted property

In transactions that involve property occupied by tenants providing a significant amount of rental income to the owner, the buyer will generally undertake significant due diligence on the terms and conditions of the leases. The buyer will also require warranties from the seller in relation to the existence of, terms and conditions of, and enforceability of the leases.

Damage to the property during the contract period

The parties will negotiate provisions in the contract dealing with when "risk" in the property passes to the buyer, as well as the circumstances under which either party, or the buyer acting unilaterally, may terminate the contract after an event of damage to the property occurring after the contract is signed, but before closing.

Concerns regarding contract parties

It is not uncommon for sellers to require guarantees from directors and/or major shareholders of a buyer company in relation to the performance by the buyer of its obligations under the contract. Payment of a significant deposit by the buyer may soften the seller's requirements in that regard.

It is not as common for buyers to require guarantees from directors and/or major shareholders of the seller. However, if the seller has obligations and potential liabilities that extend beyond closing, the buyer may require such guarantees where there are concerns about the weight of the seller's covenant.

DUE DILIGENCE

The process by which buyers investigate and evaluate real property, known as the due diligence process, will be impacted by several preliminary considerations.

First, the type of asset will help determine the level of due diligence that should be performed. For example, a buyer will probably wish to undertake a detailed due diligence and extract significant seller warranties when buying a commercial property with a single tenant. The buyer may not be as concerned in the case of a multi-tenanted residential property.

Second, the purchase and sale agreement may impact the performance of due diligence. Both the time frame, where a period of around 30 days is typical (although often longer for complex assets such as hotels, large retail complexes or major commercial towers) and the scope (such as which third parties may be contacted and/or required to provide information) will typically be governed by the provisions of such an agreement, as discussed above.

Finally, expense issues can play a factor in the level of due diligence performed by a buyer. For example, the involvement of third-party consultants and/or lawyers is advisable or even necessary for most of the due diligence items described below, but the overall project budget may not justify such expenses. The following is a general summary of the types of due diligence that can be performed for most asset types and under general circumstances.

Title investigation

The starting point for any due diligence investigation is to examine the title to the property being sold.

Each Australian state and territory has its own separate legislative regime in relation to the ownership of land and the various available tenures. Each regime is fundamentally similar in its structure and implementation, however there are some differences between each jurisdiction.

Australian real estate is regulated under a titling system, which operates on the principle of "title by registration". This system effectively does away with the need for a chain of title (ie tracing titles through a series of instruments).

Government land registers contain:

- Registered plans that define the location, size and dimensions of the property
- Details of the registered owner of the property
- Details of all registered leases over the property
- Details of registered encumbrances on the property, such as easements, restrictive covenants, mortgages, notices of resumption etc.

A buyer can obtain a title search, as well as copies of each individual encumbrance noted on the title.

Third-party reports

Third-party consultants are typically retained to investigate all aspects of the physical condition and value of the property. These reports may include:

- A Phase I environmental report (where public and other historical records of the property, surrounding property and present and former tenants are reviewed and a visual inspection of the property is performed), and, if recommended or prudent based on the results of a Phase I report, a Phase II environmental report (where soil samples are analysed for hazardous materials)
- A physical condition/structural report (based on a visual inspection of the property and its plans and specifications), which should specifically include an examination of the structure and all building services (such as air-conditioning systems, fire safety installations, elevators and all other relevant plant and equipment)
- A geo-technical/soils report (which is particularly important where future development is contemplated)
- A valuation of the property by a licensed valuer. The valuation will be particularly useful in circumstances where the buyer intends to obtain third-party financing for the acquisition of the property. Banks and lenders will only accept valuation reports from valuers approved by the bank and will require the valuer to endorse their valuation report so that the bank is entitled to rely on the report (unless the bank is commissioning its own valuation).

Financial documents

In order to verify that the financial assumptions made during negotiations are correct, the buyer will typically review and confirm historical and current financial records for the property, including, without limitation, statements of cash flow, balance sheets, statements of outgoings (including local government rates and charges and state land taxes), capital expenditure budgets and rental income.

The buyer should ascertain the potential liability for state stamp duties as well as registration fees on registration of any title transfer.

Plan and survey

Architectural plans and specifications for all buildings should be reviewed by the buyer where available. In addition, the buyer should procure a survey of the property by a licensed surveyor, which will depict the boundary of the property, the location of any improvements (including identifying any encroachments) and restrictive easements or covenants affecting the property and other such information as negotiated between the surveyor and the buyer. A full survey report can also be used to confirm the accuracy of the plan of the property lodged on the government land register, which legally defines the boundaries of the property.

Zoning

Local governments have town planning regimes governing various aspects of the use and development of real property. There will typically be planning regulations governing various aspects of the property including its construction, use (ie retail, office, light/heavy industrial, hotel/leisure or residential), density, parking, appearance and permitted signage. In many circumstances, the planning regulations can be supplemented with planning maps, specific plans and/or particular regulations.

Because the relevant information is not always straightforward or easily accessible, specialist qualified town planners are often retained to prepare a report on town planning issues, including compliance with the relevant planning scheme.

Buyers can obtain town planning certificates from the local government, which provide relevant information to assess the site from a town planning and compliance perspective. Different levels of town planning certificates are available, ranging from limited certificates (which provide limited information on zoning and identifying applicable planning instruments), right though to a full town planning certificate (which will provide complete information on all relevant town planning matters, including details of compliance with any development approvals and conditions contained in any development agreements between the local government and the seller or a prior owner of the property).

In addition, the local government will typically maintain records on each property, containing details of the various building permits, approvals, inspection records and other construction-related documents relating to the improvements located at a property. These documents will include the certificate of classification/certificate of occupancy (without which it may be unlawful to occupy a building). For a fee, the local government will provide a search report with details of all these matters.

Finally, a property may be subject to agreements entered into by the seller or a prior owner and the local government, which govern aspects of its use or development. Typically, copies of and details of compliance with such development agreements are included in a full town planning certificate.

Lease review

Where particular tenants are important to the success of a project, the buyer should review the lease terms to confirm that the financial assumptions as to the property's income and expenses are correct, and that the terms and conditions of each lease are satisfactory and appropriate in the circumstances.

In addition, the buyer should seek warranties from the seller in relation to the terms and conditions of each lease, the existence of any breaches or defaults and the enforceability of each relevant lease generally.

Service contracts

Sellers often stipulate that services contracts will be terminated with effect from closing. The buyer would need to put its own service contracts in place after closing.

Where existing services contracts are to be assigned or novated to the buyer at closing, the buyer should review existing service contracts, including any property management and leasing/brokerage agreements, utility contracts and contracts for the maintenance, replacement or repair of the property. In particular, the buyer should confirm that it can terminate and replace those contracts that are unacceptable without the payment of substantial fees or unwanted delays.

Insurance coverage

Buyers will generally work with their own insurance brokers to arrange suitable insurance for the property. If the buyer is concerned about a property's insurability, the buyer should request copies of the seller's certificates of insurance coverage.

Seller searches

Claims and liens against the seller and/or the insolvency of a seller can interfere with the consummation of the sale of real property. Although proper representations and warranties in a purchase and sale agreement can protect a buyer from the non-disclosure of such potential issues, buyers should perform their own due diligence in this regard.

Searches of appropriate court registries can identify any litigation involving the seller. Company searches of corporate sellers will confirm whether or not the seller is subject to any external administration (due to the appointment of a liquidator, receiver or administrator). For natural persons, bankruptcy searches can be performed in order to ascertain whether the seller is an undischarged bankrupt.

Property searches

Sellers must provide certain searches, principally covering title and planning matters, in order to comply with the mandatory disclosure requirements relevant to the Australian state or territory in which the property is located. In addition, buyers can conduct a range of searches and enquiries with all levels of government in order to determine whether a property is adversely affected by any government agency requirements.

In addition to the title, town planning and building records searches referred to above, buyers are generally able to conduct searches and enquiries in relation to the property which will reveal whether:

- The land is registered on contaminated land or environmental management registers, and details of any site management plans affecting the property
- Any government agency has any proposed requirements or resumptive interests in the property
- The property is affected by any mining or exploration tenures
- Electricity is connected to the property and is available under normal tariff conditions
- There are any telecommunications installations (including underground cables) on the property
- Any native title claims relating to the property
- The property is affected by flooding
- There is any unpaid land tax or local government rates.

Other more specific types of searches are available depending on the nature of the property (agricultural, coastal, environmentally significant properties etc).

TITLE INSURANCE

Australian real estate is regulated under legislative titling systems, which operate on the principle of "title by registration". This system effectively does away with the need for a chain of title (ie tracing titles through a series of instruments).

Title insurance is available in Australia, although it is rarely used as a substitute for the buyer's investigation of title to the property and undertaking relevant searches and investigations.

CLOSING AND REGISTRATION

Closing

Closing is the completion of the contractual process of selling and buying real estate. It is the event at which title to the property is legally transferred from seller to buyer.

The transfer of title at closing is consummated by the delivery of any certificate of title for the property and signed transfer documents in the form required by the legislation establishing the land register.

Closing occurs at a face-to-face meeting where representatives of the buyer, the seller, the seller's outgoing lender and the buyer's incoming lender will personally attend a meeting at which signed closing documents are delivered and the balance of the purchase price is paid.

The contract will typically require other formalities to be fulfilled at closing beyond the mere delivery of transfer documents and discharge of seller securities. Commonly, the seller will be required to turn over its property files and keys to the buyer and to provide documents conveying title to any personal property, leases and service contracts applicable to the property.

Registration of transfer documents

The buyer (or the buyer's lender where the buyer has given a mortgage over the property to raise acquisition finance) will lodge the signed transfer documents at the relevant government land registry office as soon as possible after closing. Registration gives public notice of the buyer's ownership interest in the property and provides the buyer with the benefits of an indefeasible title.

FINANCING OF COMMERCIAL REAL ESTATE

Commercial real estate lending in Australia is conducted by a wide variety of lenders, including major banks and financial institutions, managed investment funds, investment banks, credit companies and private equity lenders.

The principal financial terms of real estate loans, such as the interest rate, fees, maturity dates, security requirements, key financial covenants and provisions for prepayment are normally negotiated at the time that the borrower applies for the loan. Such terms are set forth in a term sheet, loan application, or loan commitment, depending on the formalities of the lender.

POINTS TO NOTE

- In Australia, direct ownership of real estate is held mostly under the state-based Torrens Title system of registration or under Crown Leasehold.
- The Commonwealth of Australia's policy supports foreign investment in the real estate sector where that is not inconsistent with the national interest.
- Most real estate transactions in Australia involve the parties negotiating a form of contract, taking into consideration issues specific to each transaction.
- It is strongly recommended investors undertake legal due diligence as part of the process of making the investment.
- On execution of contracts, the sellers and buyers are bound, subject to certain conditions.
- On completion or closing of the purchase and sale process the legal title of the property is legally transferred to the buyer in consideration for payment of the purchase price.

TAXATION
OF REAL ESTATE
INVESTMENTS

This chapter provides a high-level outline of the key Australian taxation considerations in relation to investment in Australian real estate or real property.

Australia has a rigorous taxation regime covering income tax (including Capital Gains Tax (CGT)), Goods and Services Tax (GST) and stamp duties. Specifically, this chapter explores the implications of asset classification for capital gains tax purposes, the importance of carefully choosing the appropriate structure/ entity to hold real property investments and the planning considerations of which to be mindful when establishing financial or other transactional arrangements connected with real property holdings.

The sections below describe the most common methods used by foreign individuals and foreign entities (foreign investors) to acquire and hold interests in Australian real estate or real property and briefly summarise the principal tax consequences of each method.

However, this information is only a general overview and an investor should seek the advice of qualified tax advisors with respect to any particular transaction to determine the most appropriate method in each case.

OVERVIEW OF THE AUSTRALIAN TAXATION SYSTEM

Taxation is spread between Australia's three levels of government.

The Federal Government collects almost 80% of the tax paid in Australia and is the only level of government that levies income tax, its major form of revenue. In addition, it levies a GST and also levies tariffs on a number of imported items.

Australian state and territory governments impose a large number of taxes, including stamp duty, land tax, mortgage duty, payroll tax and motor vehicle registration duty.

Local governments also impose taxes in the form of rates payable by landowners. However, these make up less than 5% of taxes levied on the private sector.

There is ongoing debate about tax reform in Australia. As with all decisions, businesses need to consider any proposed changes and factor them into business plans and activities. In particular, businesses should prepare before any tax change commences.

Before dealing with the tax considerations of particular investment structures, it is helpful to summarise the different types of Australian tax that may be encountered by foreign investors.

Federal individual income tax

Australian resident individuals are liable for Australian income tax on all their income and capital gains (including gains from disposals of real property) from sources anywhere in the world. Temporary residents may be able to exclude certain foreign source income and capital gains. Income tax on individuals is computed at graduated rates depending on the amount of income. From 1 July 2014, the maximum tax rate for Australian resident individuals will be 49% (this includes 2% Medicare Levy and 2% Budget Repair Levy). This tax rate applies for income greater than AU$180,000. The first AU$18,200 of income for an Australian resident individual is not subject to Australian tax and is referred to as the tax-free threshold. Foreign resident individuals do not obtain the benefit of the tax-free threshold but are generally not subject to the Medicare Levy.

Foreign resident individuals are generally taxed on all income and capital gains from Australian sources, subject to specific exemptions. A network of Double Taxation Agreements (DTAs) operates to modify these rules. From 1 July 2014, the maximum tax rate for foreign resident individuals will be 47% (this includes 2% Budget Repair Levy) and this tax rate applies for income greater than AU$180,000.

For capital gains, tax is payable only on 50% of capital gains arising from the disposal of Australian real property where certain residents (such as individuals and certain trusts) have held the real estate for more than 12 months. This is referred to as the CGT discount. The CGT discount is not available for foreign residents.

Federal corporate income tax

Similar to Australian resident individuals, Australian resident companies are taxed on all their income and capital gains (including gains from disposals of real property) from sources anywhere in the world. In contrast, foreign companies are generally taxed on income and capital gains from Australian sources. A tax rate of 30% applies to both Australian resident companies and foreign companies. The Company tax rate is proposed to be reduced by 1.5% to 28.5% from 1 July 2015, (excluding large companies).

However, companies (whether Australian resident or foreign) do not enjoy the benefit of the CGT concession that is available to individuals.

Federal GST

GST is a value-added tax of 10% that replaced wholesale sales tax and a range of state taxes in 2000. It is generally payable on supplies by businesses in Australia, including supplies of goods, services, real property, rights and obligations. It is generally applied at each stage of the production and distribution chain.

The sale of real estate by GST-registered businesses is generally subject to GST at the ratxe of 10%. However, there are a number of exceptions, including:

- The sale of existing (not new) residential premises is input taxed (the equivalent of exempt in European VAT), that is, the vendor does not charge GST, but is not entitled to claim GST credits on its expenses associated with the sale.
- The sale of property can be GST-free (ie not subject to GST – the equivalent of zero-rated in European VAT) as a going concern where it is part of the sale of the assets of an enterprise or is sold subject to lease.
- The sale of new residential premises is taxable, however, there are special GST calculation rules (referred to as the margin scheme) under which the GST liability is normally calculated on the basis of the vendor's margin.

Where the sale is subject to GST and the purchaser is also a registered business, the purchaser is ordinarily entitled to claim back the GST as a credit in its GST return (normally lodged monthly or quarterly, depending on turnover).

Entities that are carrying on an enterprise must register for GST where their annual turnover in Australia is greater than AU$75,000 (AU$150,000 for non-profit organisations).

Since there is no legislative ability for a supplier to recover an additional amount from a recipient on account of GST on a taxable transaction, it is important for suppliers to include a carefully worded GST clause in their contracts.

Capital vs revenue asset

The characterisation of whether the Australian real property is held on capital or revenue account is critical for a number of reasons. Firstly, the CGT discount is only available in respect of real property held on capital account by certain trusts, individuals and complying superannuation funds. Secondly, losses generated in respect of real property held on capital account are capital losses. Capital losses can be carried forward and are only able to be offset against capital gains. However, losses generated in respect of real property held on revenue account are revenue losses and these losses can be offset against other assessable income (whether capital gains or income).

Whether Australian real property is held on capital or revenue account is a question of fact depending on the particular circumstances. However, the Commissioner of Taxation provides guidance in *Taxation Ruling TR 92/3*, stating that if a taxpayer carrying on a business makes a profit from a transaction or operation, that profit is ordinary income (rather than capital) if the transaction or operation:

- Is in the ordinary course of the taxpayer's business, or is in the course of the taxpayer's business, although not within the ordinary course of that business, and the taxpayer entered the transaction or operation with the intention or purpose of making a profit
- Is not in the course of the taxpayer's business, but the intention or purpose of the taxpayer in entering into the transaction or operation was to make a profit or gain
- The transaction or operation was entered into and the profit was made in carrying out a business operation or commercial transaction.

Accordingly, in the Commissioner's view, profits derived from the sale of real property will be accounted for as revenue gains unless the above three tests do not apply.

The Commissioner of Taxation released *Tax Determination TD 2011/21*, which discusses the capital vs revenue distinction in respect of trusts. This determination provides that whether a gain or loss realised by a trustee of a trust is on revenue or capital account is a question of fact dependent on the particular circumstances. Further, the determination details some of the factors that should be considered in making this distinction.

A managed investment trust can elect to treat gains or losses from eligible assets (such as shares in companies or units in unit trusts) on capital account. This is discussed further below.

TAX BENEFITS OF OWNING AUSTRALIAN REAL PROPERTY

In calculating taxable income from the ownership and operation of Australian real property, the owner is generally entitled to deduct interest expense on borrowings to acquire, own and operate the real property, as well as ordinary and necessary costs of ownership and operation. Further, an owner of real property may also be entitled to claim capital allowance and capital works deductions.

Interest deductions

Generally, interest is deductible if it is incurred in gaining or producing assessable income or in carrying on a business for that purpose and is not of a capital, private or domestic nature. On this basis, interest expenses incurred when acquiring Australian real property should generally be deductible against assessable income in the year in which they are incurred, where the real property is used to produce assessable income.

To the extent that interest is capital in nature, deductions will not be allowed in respect of that interest. In a Full Federal Court decision, *St George Bank Limited v Federal Commissioner of Taxation*, it was held that interest payments made by an Australian bank to its US subsidiary were capital in nature on the basis that the overall benefit obtained by the bank was a capital benefit, being the satisfaction of regulatory capital requirements. Thus, the court held that the interest payments were not deductible.

In addition, the amount of interest deductible will be subject to the operation of Australia's debt/equity rules, which classify instruments as either debt or equity-based on the economic substance rather than their legal form. Interest payments that are attributable to a loan or interest that is deemed to be equity will not be deductible and will generally be treated as a return on equity (ie a dividend) for Australian income tax purposes. Further, there are provisions in the debt/equity rules that will treat an interest as an equity interest where it arises from an arrangement to fund a return through connected entities.

The interest deduction is also subject to the operation of the thin capitalisation rules. These rules operate when the amount of debt used to finance the Australian operations of multinational corporations exceeds specified limits. The rules disallow a proportion of the deductible finance expenses, for example interest attributable to the Australian operations.

The thin capitalisation rules may apply to:

- Australian entities that are foreign-controlled, and foreign entities that either invest directly into Australia or operate a business through an Australian permanent establishment
- Australian entities that control foreign entities or operate a business through overseas permanent establishments and associated entities.

There are two exemptions from thin capitalisation rules:

- Taxpayers and their associates claiming annual debt deductions of AU$250,000 (proposed to be increased to AU $2 million from 1 July 2014) or less
- Outward-investing Australian entities, if at least 90% of their assets are Australian.

Interest deductions reduce when the amount of debt funding of Australian operations exceeds a specified maximum. This specified maximum varies according to whether the entity is inward or outward investing.

For foreign entities holding Australian real property as investments, the maximum amount of debt will be the greater amount determined under either the safe harbour debt test or the arm's length debt test. Under the safe harbour debt test, the maximum allowable debt will generally be equal to 75% of the value of its Australian assets (that is, a gearing ratio of 3:1). This limit will be reduced from 75% to 60% of assets (effective debt to equity ratio of 1.5:1) from 1 July, 2014. The arm's length debt amount is determined by analysing an entity's activities and funding to deliver a notional amount that represents what would reasonably have been expected to be the entity's maximum arm's length debt funding during the period.

Capital allowances and capital works deductions

Under the capital allowance regime, the decline in value of income-producing assets is generally tax deductible over the asset's estimated useful life. Similarly, deductions are available under the capital works regime for certain capital expenditure on income-producing buildings and structures.

However, there is a specific regime (referred to as Division 250) that denies or reduces certain capital allowance deductions that would otherwise be available for an asset. Division 250 applies if the asset is put to a "tax-preferred use" and the taxpayer has an insufficient economic interest in the asset. An asset is put to a tax-preferred use if the end user is a lessee of the asset and the asset is to be used by a tax-preferred end-user (eg government agencies), or the asset is to be used wholly or principally outside Australia by a non-resident.

TYPES OF ENTITIES

The type of entity used to acquire the Australian real property will often determine the principal Australian tax implications. Commonly, entities or a combination of entities such as companies, trusts (either flow-through or taxed as companies), limited partnerships and joint ventures may be used to acquire Australian real property. Also, stapled structures (where investors hold interests in two or more entities and these securities cannot be bought or traded separately) are frequently used.

Each of these entities, or a combination of entities, has distinctive tax characteristics that must be carefully examined to determine its appropriateness in carrying out the acquisition from an Australian tax perspective.

There are several important tax reviews/reforms recently announced in Australia, such as the consideration of the possible reform of and expansion of the Collective Investment Vehicles, including whether a broader range of tax flow-though vehicles should be permitted. Further, the current review includes the consideration of changes to the limited partnership regime and the rewrite of existing trust law provisions.

The general tax attributes of commonly used entities are summarised below.

Companies

Companies are treated as a separate legal entity. As discussed above, a tax rate of 30% currently applies to both Australian resident companies and foreign companies. This rate is proposed to be reduced by 1.5% to 28.5%, effective 1 July 2015 (excluding large companies).

Generally, losses generated by companies are carried forward, provided certain conditions are satisfied and offset against future income.

Trusts

Trusts are generally treated as flow-through entities. The trustee of the trust will not be taxed on the net income of the trust, provided that unitholders/beneficiaries are presently entitled to all the income of the trust. In this case, it is the unitholders/beneficiaries that are subject to tax on the net income. The trustee is taxed at the highest marginal tax rate on the portion of net income of the trust to which no beneficiary/unitholder is presently entitled.

Generally, losses generated by the trust will be quarantined at the trust level and cannot be distributed to unitholders/beneficiaries. These losses may be carried forward, provided certain conditions are satisfied and offset against future income.

As noted above, the Federal Government has announced the rewrite of existing trust law provisions to address the major uncertainties that currently exist around trusts.

For GST purposes, a trust is treated as a separate entity (technically, it is the trustee acting in its capacity as trustee of the trust that is treated as the entity). The trust is generally registered for GST and enters into transactions for GST purposes.

Partnerships

Generally, partnerships that are not limited liability partnerships are also treated as flow-through entities. However, unlike trusts, partnerships facilitate the flow-through of both net income and net losses of the partnership to the partners. Unlimited partnerships bring with them practical difficulties, including the unlimited liability of the underlying partners.

For GST purposes, a partnership is treated as a separate entity. The partnership is generally registered for GST and enters into transactions for GST purposes.

Limited liability partnerships are generally taxed as companies and do not facilitate flow-through treatment. However, not all limited liability partnerships are taxed as companies. For example, Australia's venture capital provisions enable certain limited partnerships to be treated as flow-through entities. These provisions are restrictive and generally not available for property investments.

As noted above, the Federal Government is reviewing the limited partnership regime, considering changes to the limited partnership regime and examining the treatment of venture capital limited partnership vehicles in a way that recognises its policy objectives. In addition, certain foreign limited partnerships or companies may be treated as flow-through entities under Australia's "foreign-hybrid" rules, provided that certain conditions are satisfied including that the entity has flow-through treatment in its country of residence/establishment.

IMPORTANCE OF TREATIES

In the event that cross-border transactions take place, DTAs should be considered when determining where (and to what extent) liability to taxation may arise. These treaties typically reduce the rate of withholding tax on passive income, as described below. Further, DTAs may be relied upon in certain circumstances to ensure that double taxation does not arise. The terms of Australia's DTAs take priority over domestic tax legislation.

The decision in *FCT v Lamesa Holdings BV 97 ATC 4752* (Lamesa) illustrates the effectiveness of the protection offered by DTAs. In Lamesa, a US-based group was entitled to treaty protection from Australian tax due to the favourable treaty between the Netherlands and Australia. The US group held its interests in Australian real property (otherwise subject to tax in Australia on disposal) through a Dutch holding company. In the aftermath of Lamesa, the International Agreements Act was amended to ensure that Australia's DTAs do not protect taxpayers from tax in circumstances where real property is held through interposed entities. However, contrary to the views of the ATO, there are strong grounds to argue that several of Australia's DTAs continue to protect non-residents from CGT on the disposal of assets with the necessary connection with Australia.

Australia has introduced a general CGT exemption for foreign residents. Under these rules, foreign residents are generally exempt from Australian CGT, except where the capital gain is derived from interests (direct or indirect) in Australian real estate or assets used in carrying on a business in Australia through a permanent establishment. These rules align Australian CGT rules with the foreign resident CGT exemptions provided by other Organisation for Economic Cooperation and Development member countries.

In two Federal court cases (*Virgin Holdings* [2008] FCA 1503; *Undershaft* [2009] FCA 41), it was held that Australia's "pre-CGT" treaties (ie those entered into prior to the introduction of capital gains tax) apply to capital gains and the taxing rights of the contracting states to tax capital gains.

Australia's more recent DTAs specifically state that nothing in the DTA impacts upon Australia's rights to tax non-residents on the disposal of their CGT assets. However, in certain DTAs (eg the Australia/Netherlands DTA), where the non-resident does not have a taxable presence in Australia (eg a permanent establishment), only Australia is given the taxing rights in relation to the disposal of real property (or entities that wholly or principally hold real property assets).

Also, a number of Australia's recent DTAs (such as Australia/New Zealand DTA and Australia/Japan DTA) recognise managed investment trusts.

INVESTMENT THROUGH LOANS

A foreign investor may also invest in Australian real estate by making a loan to the owner of the property. In general, interest income from a real estate loan will be subject to 10% withholding tax, as described below. The withholding tax can be reduced or eliminated by applicable tax treaties.

In addition, certain types of foreign investors may be exempt from interest withholding tax (eg certain foreign pension funds). Further, there are exemptions from interest withholding tax for interest paid to foreign residents on certain public debentures and debt interests issued by companies.

Care needs to be taken in structuring the loan so that it is not treated for Australian income tax purposes as if it were in substance equity. If the loan is treated as equity, the interest paid on the loan will be taxed as dividends.

Foreign investors may wish to secure the repayment of their loans by taking a mortgage over the property as security. Mortgage duty will be payable if the mortgage is taken over property in the state of New South Wales.

TAXATION OF EQUITY INVESTMENTS

Income from property

Generally, income derived from the property (eg rental income) will be treated as assessable income and be taxable in the hands of the owner at the owner's tax rate, as described above.

Tax on gain from dispositions

The taxation of the gain arising on the disposal, or other disposition, of Australian real property will depend on whether the property is held on capital or revenue account, as outlined above. If the property is held on revenue account, the gain will be included in the assessable income of the owner and taxed at the owner's tax rate.

If the property is held on capital account, the net capital gain will also be included in the assessable income of the owner. However, there are a number of concessions and exemptions that can apply in respect of capital gains. One such concession is available to investors who are non-residents of Australia for tax purposes. Generally, a foreign investor will only make a capital gain or loss on disposal of a capital asset if either:

- They have a direct or indirect interest in Australian real property. An indirect interest includes an interest held through a non-portfolio interest, that is, when an interest of 10% or more is held through an interposed entity. However, non-portfolio interests held by foreign residents in both Australian and foreign entities will only be subject to Australian CGT when at least 50% of the value of the entity's assets are attributable to underlying Australian real property; or
- The assets have been used in carrying on a business through an Australian permanent establishment.

Accordingly, any gain arising from a disposal of a direct interest in real property will not be exempt from CGT. However, disposal of indirect interests may be exempt from CGT in certain circumstances, depending on the percentage of Australian real estate held as compared to the other assets.

Withholding tax

In Australia, withholding tax is payable in respect of certain passive income paid to foreign investors. In particular:

- 30% withholding tax for dividends paid out of untaxed profits. Dividends paid from taxed profits are exempt from withholding tax
- 10% withholding tax for interest.

These rates may be reduced or eliminated pursuant to an applicable tax treaty. In addition, certain exemptions from withholding tax are available for certain types of payments to certain foreign investors (eg interest paid to a foreign pension fund). Further, there are exemptions from interest withholding tax for interest paid to foreign residents on certain public debentures and debt interests issued by companies.

DIRECT EQUITY INVESTMENT

The following briefly summarises the tax consequences to a foreign investor of a direct equity investment in Australian real estate.

By a foreign individual

A foreign individual who holds Australian real estate directly in his or her name will be subject to Australian income tax on the net income from owning and operating the property (eg rental income less operating expenses, depreciation, interest and other related expenses) at the tax rates outlined above.

Regardless of whether the interest in the real estate is held by the foreign individual on revenue or capital account, gains on the sale of property will be included in the assessable income of the foreign individual and taxed at the rates outlined above.

By a foreign corporation

A foreign corporation that holds Australian real estate directly in its own name will be subject to Australian income tax on the net income from owning and operating the property (eg rental income less operating expenses, depreciation, interest and other related expenses) at the current corporate tax rate of 30%.

Regardless of whether the interest in the real estate is held by the foreign corporation on revenue or capital account, gains on the sale of property will be included in the assessable income of the foreign corporation and taxed at the corporate rate above.

EQUITY INVESTMENT THROUGH AN AUSTRALIAN CORPORATION

The following briefly summarises the tax consequences to a foreign investor of investing in Australian real estate indirectly through an Australian corporation.

By a foreign individual

Income from the investment will generally be subject to Australian tax at the current corporate tax rate of 30%. The Australian corporation will be subject to Australian income tax on the net income from owning and operating the property (eg rental income less operating expenses, depreciation, interest and other related expenses) at the current corporate tax rate of 30%. The tax paid by the Australian corporation will give rise to franking credits. These franking credits may be attached to dividends (referred to as "franked dividends") paid by the Australian corporation to the foreign individual. If so, no further Australian income tax or withholding tax will be paid in respect of the dividend.

In contrast, dividends paid out of untaxed profits (known as "unfranked dividends") will be subject to Australian withholding tax at the current rate of 30%. This rate may be reduced by any applicable tax treaties.

Regardless of whether an Australian corporation holds the real estate on revenue or capital account, gains on the sale of property will be included in the assessable income of the corporation and taxed at the corporate rate above. Australian corporations are not eligible for any CGT concession.

Any dividends or liquidation distributions paid by the corporation from the sale of the real estate will be subject to same tax treatment as the dividends described above.

If the foreign individual holds his or her interest in an Australian corporation on revenue account, gains on the sale of their shares in the corporation will be included in the assessable income of the foreign individual and taxed at the tax rates outlined above. If the shares in the corporation are held on capital account, gains on the sale of shares may also be included in the assessable income of the foreign individual as a capital gain, depending on the following circumstances:

- If less than 50% of the value of the corporation's assets is attributable to underlying Australian real property, the capital gain will be disregarded.
- If at least 50% of the value of the corporation's assets is attributable to underlying Australian real property, but the foreign individual holds less than 10% of the total interests in the corporation, the capital gain will be disregarded.
- If at least 50% of the value of the corporation's assets is attributable to underlying Australian real property and the foreign individual holds at least 10% of the total shares in the corporation, the capital gain will be included in the assessable income of the foreign individual.

By a foreign corporation

The Australian income tax consequences of a foreign corporation investing in Australian real estate indirectly through an Australian corporation will generally follow the consequences outlined above for foreign individuals, except that foreign corporations pay tax at the current corporate tax rate of 30% and are not eligible for the CGT concession.

EQUITY INVESTMENT THROUGH A FOREIGN CORPORATION

The Australian income tax consequences for a foreign corporation have been outlined above. Dividends or other distributions paid by a foreign corporation to a foreign individual will not be subject to Australian income tax.

Generally, disposals of interests in a foreign corporation should not be subject to Australian income tax. However, Australian CGT could potentially apply. If a foreign individual disposes of his or her interest in a foreign corporation, the Australian CGT consequences will generally follow the consequences of a foreign individual disposing of an interest in an Australian corporation, as outlined above.

EQUITY INVESTMENT THROUGH AN AUSTRALIAN PARTNERSHIP

The Australian tax consequences for a foreign investor investing in Australian real estate through an Australian partnership, foreign partnership or other entity treated as a partnership for Australian taxation purposes (eg certain foreign limited liability companies and partnerships) are similar to the results of a direct equity investment outlined above.

As noted above, partnerships are generally treated as flow-through entities, facilitating the flow-through of both net income and net losses of the partnership to the partners. Accordingly, a foreign investor who holds Australian real estate indirectly through a partnership will be subject to Australian income tax on their share of the net income of the partnership from owning and operating the property (eg rental income less operating expenses, depreciation, interest and other related expenses) at their respective tax rates.

In addition, foreign investors will be subject to taxation on their share of any gain arising from a disposal of an interest in Australian real estate in the same manner as if they had held the interest in the real property directly, as outlined above.

EQUITY INVESTMENT THROUGH AN AUSTRALIAN MANAGED INVESTMENT TRUST

Australian tax law provides favourable tax treatment for foreign investors in Australian unit trusts that qualify to be a Managed Investment Trust (MIT). In particular, there has been a significant reduction in withholding tax on certain distributions (predominantly rental income and certain capital gains) from Australian MITs to foreign investors. Essentially, the previous non-final 30% withholding tax rate has been reduced to a final withholding tax rate of 15% from 1 July 2012.

Most importantly, to be eligible for this significant reduction in the Australian withholding tax for these distributions from Australian MITs (principally "managed investment schemes"), the foreign investor must be resident in a country with which Australia has an effective Exchange of Information (EOI) arrangement on taxation matters. These countries are listed below.

Anguilla	Fiji	Kiribati	Singapore
Antigua and Barbuda	Finland	Malaysia	Slovakia
Argentina	France	Malta	South Africa
Aruba	Germany	Mexico	Spain
Bahamas	Gibraltar	Monaco	Sri Lanka
Belgium	Guernsey	Netherlands	St Christopher and Nevis
Belize	Hungary	Netherlands Antilles	St Vincent and Grenadines
Bermuda	India	New Zealand	Sweden
British Virgin Islands	Indonesia	Norway	Taipei
Canada	Ireland	Papua New Guinea	Thailand
Cayman Islands	Isle of Man	Poland	Turks and Caicos Islands
China	Italy	Romania	UK
Czech Republic	Japan	Russia	USA
Denmark	Jersey	San Marino	Vietnam

From 1 July 2012, the Cook Islands, Macau, Mauritius and South Korea were added to the list of EOI countries above.

Some countries with which Australia has EOI agreements or double tax treaties, including Switzerland and Austria, have not currently been included on the list. In addition, Australia has entered into tax information exchange agreements with a number of countries (such as Switzerland, Samoa and Vanuatu), however, there is a time lag between the entry into these agreements and the time which these countries are gazetted and added to the list above.

The lower withholding tax rates apply to "fund payments", ie distributions primarily of rental income and capital gains from Australian real property by Australian MITs.

The lower withholding tax rates do not apply to dividend, interest and royalty income, which are subject to their own withholding tax rates. In addition, capital gains from non-taxable Australian property are not subject to withholding (since foreign investors will generally be exempt from CGT in respect of such capital gains). Only distributions of Australian source net income of these trusts to non-residents will benefit from the lower withholding tax rates.

Distributions made by MITs to foreign investors that are resident in countries not on the list will generally be subject to a final withholding tax of 30%. In addition, distributions made by unit trusts that do not qualify as a MIT to foreign investors will be subject to a non-final withholding tax at the foreign investor's own tax rate, as outlined previously.

A new taxation regime for MITs is proposed to be introduced from 1 July 2015.

GST

GST is a value-added tax of 10% that replaced the previous Wholesale Sales Tax on goods and a range of state taxes in 2000. It is generally payable on a broad range of supplies by businesses in Australia, including supplies of goods, services, real property, rights and obligations, and is generally applied at each stage of the production and distribution chain.

GST has a significant impact on the profitability of a real estate project, as well as the choice of financing, the purchaser's cash flow and the amount of stamp duty payable. It can also give rise to significant tax compliance costs. Accordingly, it is important that the investment and operational structure of a real estate project minimises GST inefficiencies/costs. GST must be considered prior to establishing a project structure. In particular, the special GST rules that apply to property, cross-border arrangements and financial services must be considered carefully in the early stages of a project.

There are generally three types of supplies for GST purposes:

- Taxable supplies, where the supply attracts GST and the supplier is entitled to claim GST credits on its expenses associated with the supply
- Input taxed supplies, where the supply does not attract GST, however, the supplier is not entitled to claim GST credits on its expenses associated with the supply
- GST-free supplies, where the supply does not attract GST and the supplier is entitled to claim GST credits on its expenses associated with the supply.

The GST implications of real estate transactions depend on the nature of the property and the availability of any GST concessions. The following table summarises the GST treatment of different types of real estate transactions.

Residential property

Sale or long term lease (at least 50 years) of new residential property	Taxable (GST can be calculated under the margin scheme – see Note 1)
Sale of vacant land	Taxable (GST can be calculated under the margin scheme – see Note 1)
Sale or long term lease (at least 50 years) of existing residential property	Input taxed
Sale of partly completed residential property	Taxable (GST can be calculated under the margin scheme – see Note 1) or GST-free as a going concern (see Notes 2 and 3)
Lease (other than long-term lease) of new or existing residential property	Input taxed

Commercial residential property (see Note 3)

Sale of commercial residential property	Taxable or GST-free as a going concern (see Notes 2 and 3)
Short-term accommodation (less than 28 days) in commercial residential property	Taxable
Long-term accommodation (28 days or more) in commercial residential property	Concessionally taxed at 5.5% or input taxed at the option of the supplier

Commercial and industrial property

Sale of commercial or industrial property	Taxable or GST-free as a going concern, particularly where tenanted (see Notes 2 and 3)
Lease of commercial or industrial property	Taxable

Other

Sale of farm land for farming	GST-free (see Note 3)
Sale of land with no improvements by government	GST-free

Notes:

1 There are special GST calculation rules for the sale of new residential property (referred to as the margin scheme), under which the GST liability on the sale is normally calculated on the basis of the vendor's margin.

2 The sale of the assets of an enterprise can be GST-free as a going concern where certain requirements are met. The going concern exemption has cash flow benefits and also often reduces the stamp duty payable on the sale.

3 Commercial residential premises generally cover hotels, motels, boarding houses, caravan parks, camping grounds and similar premises.

Businesses are generally required to register for GST in Australia where their annual turnover in Australia is greater than AU$75,000 (AU$150,000 for non-profit organisations). Registered businesses must lodge GST returns (generally monthly or quarterly, depending on turnover). Businesses that are registered for GST need to have accounting systems in place to account for GST and must be able to issue valid tax invoices to their customers for taxable transactions. Further, since there is ordinarily no legislative ability for a supplier to recover an additional amount from a recipient on account of GST on a taxable transaction, it is important for businesses to include a carefully worded GST clause in their contracts.

For non-resident businesses, there are various mechanisms that may allow them to simplify their GST compliance, including the use of local agents and reverse charge agreements. It is important that such issues are considered before the business starts to operate in Australia. The Federal Government has announced substantive amendments to the GST cross-border rules. At the time of publication, however it is expected to be sometime in 2013.

If a real estate transaction is subject to GST and the recipient is a registered business, the recipient is ordinarily entitled to claim back the GST as a credit in its GST return.

It is also important to consider the GST consequences of the financing aspects of real estate transactions. Generally, real estate finance falls within the GST financial supply rules. Financial supplies are generally input taxed (and therefore GST credits on finance expenses cannot be claimed). However, there are a number of special GST rules that apply in this area, for example, the Financial Acquisitions Threshold and the borrowings exemption that may allow businesses to claim GST credits on expenses, regardless of whether they make financial supplies.

Financial supplies are also relevant to other aspects of real estate transactions. For example, mortgages, guarantees and other forms of security taken over real estate are generally financial supplies, as are transactions involving shares and units in trusts. Such arrangements need to be carefully structured for GST purposes to ensure GST is not a real cost to the parties.

The above discussion is a brief summary of some of the relevant GST rules applicable to real estate transactions. However, complex GST issues often arise in real estate transactions and it is crucial for businesses to seek GST advice to ensure that unexpected GST consequences do not arise.

STATE AND LOCAL TAX CONSIDERATIONS

State stamp duty

All Australian states and territories impose transfer or conveyance duty on a sale of Australian real property, including buildings and improvements. Each state's and territory's stamp duty law is different. The liability for stamp duty arises on first execution of the relevant sale/purchase agreement. The sale of real property is subject to duty at rates of up to 7%, depending on the value and location of the property.

In all jurisdictions, the purchaser is liable to pay the stamp duty on the sale of property and the stamp duty must be paid before the purchaser can be registered as the legal owner of the property in the relevant jurisdiction. In Queensland, the vendor and the purchaser are jointly and severally liable for the stamp duty.

The amount of duty payable is calculated by reference to the "dutiable value" of the real property. The dutiable value is the greater of the market value of the real property (disregarding any liabilities to which the property is subject, such as mortgages) and the consideration paid for the real property (inclusive of GST).

Generally, transactions involving shares in companies or units in trusts that are listed on the Australian Stock Exchange (or a comparative overseas exchange) are not subject to stamp duty in any Australian jurisdiction. Transactions involving shares or units in unlisted companies or trusts are generally only subject to stamp duty in New South Wales or South Australia, at lower rates of stamp duty (0.6% flat rate).

However, certain acquisitions of shares and units in companies and trusts, respectively, that own Australian real property are subject to stamp duty, in all Australian jurisdictions, at the same rates as a transfer or conveyance of real property (referred to as "land-rich" or "landholder" duty). These rules generally apply when:

- There is a significant or majority acquisition in a company or unit trust
- That company or unit trust is land-rich or a landholder.

The exact land-rich/landholder rules and threshold tests vary depending on each jurisdiction. Additionally, in certain limited circumstances, these rules can apply to acquisitions of shares or units in listed companies or trusts. The table on the next page outlines the landholder duty rates and thresholds in each state and territory and whether the rules can apply to acquisitions in listed entities (as at 1 Jan 2014).

STATE	LAND VALUE IN STATE	LAND AS % OF TOTAL ASSETS	MAXIMUM RATE OF DUTY	LISTED ENTITIES COVERED?
New South Wales	$2 million	-	7%	Y
Queensland	$2 million	-	5.75%	Y
Victoria	$1 million	-	5.50%	Y
Western Australia	$2 million	-	5.15%	Y
South Australia	$1 million	-	5.50%	Y
Tasmania	$500,000	60%	4.5%	N
Australian Capital Territory	-	-	7%	N
Northern Territory	$500,000	-	5.45%	Y

State land tax

Each Australian state and territory imposes land tax at varying levels and conditions. Generally, land tax is payable annually based upon the unimproved value of land owned and applies only above a certain value.

The thresholds and maximum rates of land tax in each Australian state and territory for the 2012 year are as follows:

STATE	THRESHOLD	MAXIMUM RATE
New South Wales	$412,000	2.0%
Queensland	$350,000	2.0%
Victoria	$250,000	2.25%
Western Australia	$300,000	2.43%
South Australia	$316,000	3.7%
Tasmania	$25,000	1.5%
Australian Capital Territory	$75,000	1.8%
Northern Territory	-	-

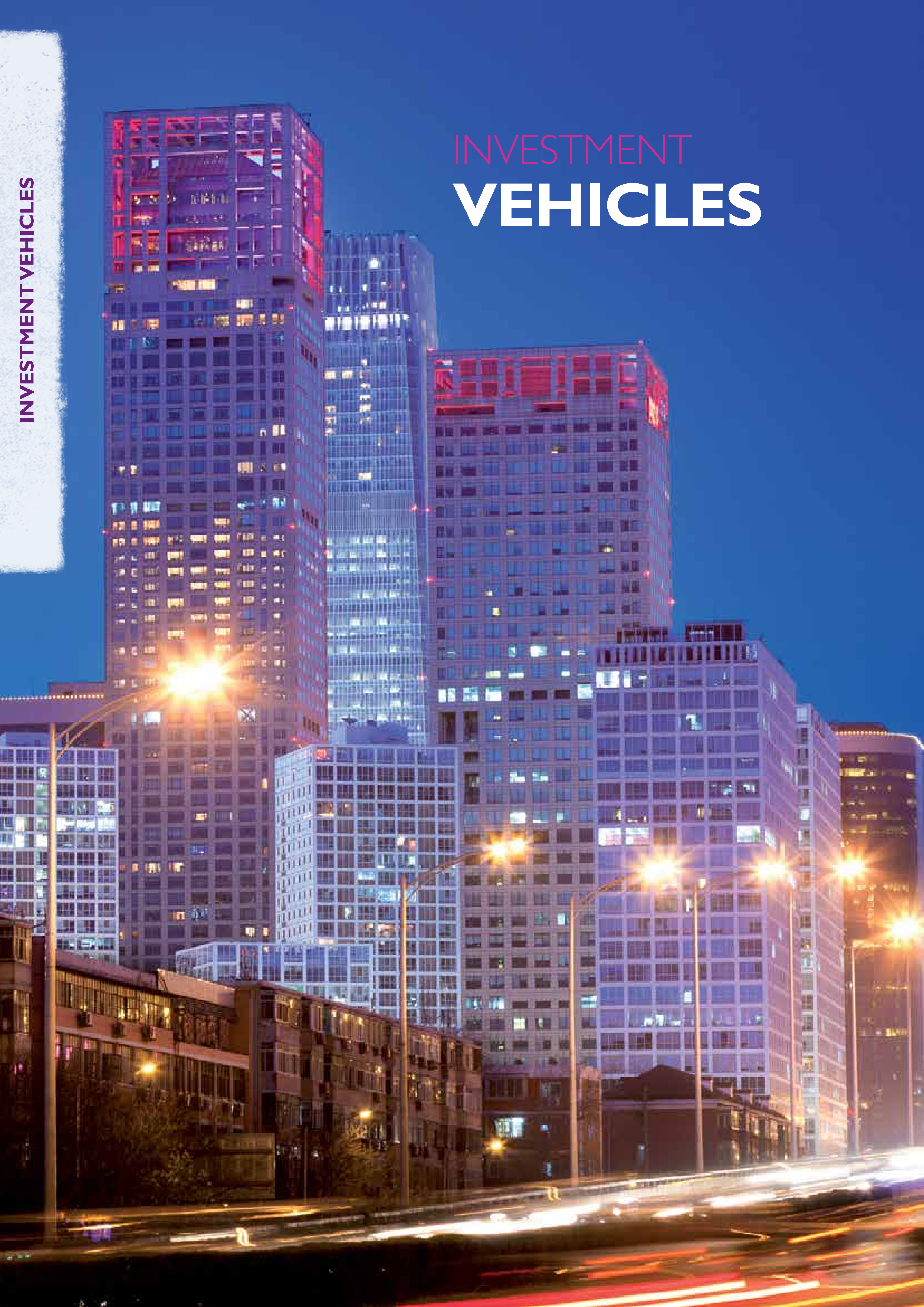
Depending on the relevant jurisdiction, certain exemptions may be available from land tax, such as for land that is:

- The owner's principal place of residence
- Primary production land
- Used for religious purposes
- Used as a medical establishment
- Used to operate a retirement village, or for related purposes
- Owned by a charitable institution.

POINTS TO NOTE

- Tax benefits of owning Australian real estate include the entitlement to deduct interest expenses on borrowings to acquire, own and operate the property, as well as the ordinary and necessary costs of ownership and operation.
- Owners may also be entitled to claim capital allowance and capital works deductions.
- Double Taxation Agreements should be considered. These treaties generally reduce the rate of withholding tax on passive income and may ensure that double taxation does not arise.
- Equity investments are subject to taxation. This includes income derived from the property, the gain arising from the disposition of the property and withholding tax payable on certain passive income paid to foreign investors.
- Most states and territories impose stamp duty on the acquisition of interests in real estate and the impact of this should be carefully considered by foreign investors.
- GST is a value-added tax of 10% and has a significant impact on the profitability of a real estate project.

INVESTMENT VEHICLES



KEY CONSIDERATIONS

A number of different types of entity structures are available in Australia for real property investment and ownership. The considerations to be weighed by an investor in selecting a particular investment vehicle, are numerous and case-specific. Those considerations will depend on the laws of the investor's country of origin, the investor's existing corporate structure and internal requirements, the nature and length of the contemplated investment and cross-border tax ramifications. It is critical that a non-Australian investor contact a suitably qualified Australian attorney before investing in Australian real estate, so that all relevant factors can be weighed before a decision is made as to the type of investment vehicle that should be employed.

TYPES OF CORPORATE ENTITIES

The following is a brief summary of various types of business entities available for investment in real estate in Australia.

This list contains the main types of corporate vehicles available to investors. In some circumstances (noted below), the precise rules governing the entities described below are mandated by the state in which the entity is formed. The exact characteristics or requirements will then depend on the laws of that state.

Proprietary company

A proprietary company (distinguished by the abbreviation "Pty Ltd" or "Pty" at the end of its name) is a form of corporation that either must be (i) limited by shares, where shareholders' liability for debts of the company is limited to the amount unpaid on their shares (most common); or (ii) unlimited, where shareholders have unlimited liability for the debts of the company. A proprietary company must have at least one shareholder, no more than 50 non-employee shareholders and at least one director who must ordinarily reside in Australia.

Public company

A public company (usually distinguished by the abbreviation "Ltd" or "Limited" at the end of its name) is similar to a proprietary company with regards to the limited liability of its shareholders. However, there is no restriction on the number of shareholders and public companies may raise funds from the public. They must have at least three directors, with at least two ordinarily residing in Australia, and must appoint at least one company secretary who ordinarily resides in Australia.

Branch of a foreign corporation

A company incorporated or formed outside Australia may carry on business in Australia, provided it has registered or applied to be registered under the *Corporations Act 2001* (Cth). A foreign corporation registered in Australia requires at least one local agent – an Australian company or resident in Australia – to be appointed to act on behalf of the company.

General partnership

A general partnership is an association comprised of two or more persons who agree to carry on a business. Each partner contributes cash, property and/or other services to the partnership. The partners are all jointly and severally liable for the debts of the firm and have unlimited liability. A general partnership is usually created by a partnership agreement. Although it can exist by conduct of the parties, it is preferable to have a written agreement.

Limited Liability Partnership

In Limited Liability Partnerships (LLPs), special partners are liable only to the extent of their capital contributions but have no participation in the management of the partnership, which is carried on by a general partner (which has unlimited liability). A LLP is formed by and on registration of the partnership under the relevant state-based Partnership Act.

Discretionary trust

A discretionary trust is a trust under which beneficiaries have no fixed entitlements to the capital or income of the trust, with the trustee having discretion to choose beneficiaries for these purposes. In general, a discretionary trust is commonly used for family purposes. It is common for a corporation to be the trustee of a discretionary trust.

Unit trust

A unit trust is a common structure adopted for property investments in Australia.

In a unit trust, entitlement to the benefits of the trusts is divided into units similar to shares in a company. The investors hold a number of units according to their investment. Almost invariably a corporation is the trustee of a unit trust.

Unit trusts are commonly used for public investment purposes. Almost all publicly traded trusts formed for real estate investment purposes in Australia are unit trusts (otherwise known as managed investment schemes). Managed investment schemes are independently regulated by legislation. The legislation in question generally attempts to impose certain standards on the management of the trust and to provide safeguards to investors in units.

Joint venture

Foreign investors may enter into contractual joint venture agreements with Australian entities to carry out commercial activities, usually for a limited period or a specific purpose. These ventures are not recognised as a separate legal entity. As far as possible, Australian joint ventures are usually structured to avoid classification as a partnership.

The following chart describes in more detail the basic differences between these corporate vehicles.

	Number of owners	Types of owners*	Classes of owners	Transferability of ownership interests	Owners' agreement	Management and control	Legal liability of owners
Proprietary Company	Minimum of one shareholder	A proprietary company limited by shares must have no more than 50 shareholders, not including employee members	Permitted	Usually restrictions on the right of shareholders to transfer shares	The constitution of the company forms an agreement between the company and the shareholders	Must have at least one director who must ordinarily reside in Australia. Not required to have a company secretary, but if it does have one or more, at least one of them must ordinarily reside in Australia. The company's affairs are run by its directors	In a proprietary company limited by shares, the shareholders' liability for debts of the company is limited to the amount unpaid on their shares
Public Company	Minimum of one shareholder	No restrictions	Permitted	Normally, no restriction on transfer of shares	The constitution of the company forms an agreement between the company and the shareholders	Must have at least three directors, at least two of whom must ordinarily reside in Australia. It must also have at least one company secretary, one of whom must ordinarily reside in Australia. The company's affairs are run by its directors	In a public company limited by shares, the shareholders' liability for debts of the company is limited to the amount unpaid on their shares
Branch of a Foreign Corporation	Regulated by laws of foreign corporation	Regulated by laws of foreign corporation	Regulated by laws of foreign corporation	Regulated by laws of foreign corporation	Regulated by laws of foreign corporation	A foreign corporation registered in Australia requires at least one local agent – an Australian company or resident in Australia – to be appointed to act on behalf of the company. The foreign company must also maintain a registered office in Australia	Regulated by laws of foreign corporation
General Partnership	Minimum of two general partners	No restrictions	Permitted	Permitted, unless there are partnership agreement restrictions	An oral agreement is permitted, but a written agreement is recommended	All partners have equal rights in management unless the partnership agreement provides the contrary	All partners are jointly and severally liable for acts and omissions of the other partners and the partnership debts and obligations
Limited Liability Partnership	Minimum of two partners (one general partner and one limited partner)	No restrictions	Permitted	Permitted, unless there are partnership agreement restrictions	A written agreement is required	General partner(s) manage the business of a LLP	General partners are personally liable for partnership debts and obligations, the limited partner's liability cannot exceed their financial contribution to the partnership
Discretionary Trust	Minimum of one beneficiary	No restrictions	Unusual	No interest to transfer	A written agreement (trust deed) is required	The trustee is the legal owner of the trust property although not the beneficial owner. The trustee carries out all transactions of the trust in its own name, must sign all documents for and on behalf of the trust and must administer the trust in accordance with the terms, conditions and powers enumerated in the trust deed and implied by law	Provided that a trustee acts in accordance with the terms, conditions and powers contained the trust deed and implied by law, the law will protect it from any liability in respect of those actions or any claim by any beneficiary, despite the result of those actions. Beneficiaries generally have no legal liability to third parties

	Number of owners	Types of owners*	Classes of owners	Transferability of ownership interests	Owners' agreement	Management and control	Legal liability of owners
Unit Trust	Minimum of one unitholder	No restrictions	Permitted	Permitted, unless there are trust deed restrictions	A written agreement (trust deed) is required	The trustee is the legal owner of the trust property although not the beneficial owner. The trustee carries out all transactions of the trust in its own name, must sign all documents for and on behalf of the trust and must administer the trust in accordance with the terms, conditions and powers enumerated in the trust deed and implied by law	Provided that a trustee acts in accordance with the terms, conditions and powers contained in the trust deed and implied by law, the law will protect it from any liability in respect of those actions or any claim by any unitholder, despite the result of those actions. Unitholders have no legal liability to third parties
Joint Venture	Minimum of two participants	No restrictions	Permitted	It depends on the provisions of the joint venture agreement	An oral agreement is permitted (but highly unusual). A written agreement is recommended	It depends on the joint venture agreement. Generally the venture will be controlled by an operating committee	It depends on the joint venture agreement (potentially venturers are liable severally, proportionately to their interest in the venture)

It is critical that a non-Australian investor contact a suitably qualified Australian attorney before investing in Australian real estate.

POINTS TO NOTE

- Types of entity structures available in Australia for real property investment and ownership include proprietary company, public company, branch of a foreign corporation, general partnership, limited liability partnership, discretionary trust, unit trust and joint venture.
- The tax implications will be dependent on the chosen entity.
- Foreign investors should carefully weigh the considerations before selecting a particular investment vehicle.

LEASES

UNDERSTANDING LEASES

In Australia, a lease constitutes a contract between the landlord and a tenant. The lease grants exclusive possession and use of premises to the tenant in exchange for payment of rent (amongst other payments) to the landlord.

There are certain laws that govern how lease transactions are made and maintained between the parties. The laws are predominantly state-based, with some aspects of leasing being governed by local authorities (eg use restrictions may be governed by the local council within that state, such as Sydney City Council within New South Wales).

In addition, courts generally resolve lease disputes by applying a combination of common law cases and statute. Depending on the jurisdiction and what type of lease (eg residential leases), some jurisdictions may allow for disputes to be taken to certain tenancy boards for assistance in dispute resolution.

COMMERCIAL LEASES

Commercial leases come in different sizes and varieties. The most common kinds of commercial leases are:

Multi-tenant office leases

This is usually a lease within a high-rise office building, where different tenants have leased premises within a building and will pay a rental amount, generally monthly, in addition to a proportionate share of the landlord's expenses of repairing and maintaining the building and the common areas (eg gardens or kitchens). Generally, the landlord is responsible for the maintenance and repair of the common areas of the building, which all of the tenants and the public are able to access.

Single-tenant lease

This usually involves a single tenant, which has exclusive use of the entire property. Generally, single tenants often have the responsibility to maintain all of the property and pay nearly all costs related to the property. Sometimes this can extend to structural and capital repairs, depending on the lease terms.

Retail lease

Retail leases typically exist in multi-tenant retail shopping centres and often have unique legislation governing them, which is discussed further below.

Other leases

There are other types of leases that are often tailored to the tenant's specific use, such as industrial, manufacturing, distribution centre, parking garage and telecommunications equipment area leases.

RESIDENTIAL LEASES

A detailed explanation of the residential leasing system in Australia is beyond the scope of this guide. In general, tenants of residential leases are entitled to extra protection against discrimination from landlords and real estate agents. Residential leases are governed by state-specific legislation, which is generally drafted to protect the tenant (eg long notice periods to be provided if the landlord wishes to increase the rent or terminate the lease).

Some jurisdictions have tenancy databases, which provide agents with information about the previous tenancies of prospective tenants where there have been problems. This information helps agents assess if an applicant is likely to be a financial risk to the landlord. Tenants may be listed on a tenancy database for serious breaches of their residential leases.

REGISTRATION

Generally, leases involving lease terms (in some Australian jurisdictions, including any options to renew the lease) that exceed a prescribed term for short-term leases must be registered on a public register with the relevant government authorities. A short-term lease (the concept of which differs between jurisdictions, but in most jurisdictions this is a lease of three years or less) does not need to be registered with the relevant government authority. In most Australian jurisdictions, registration is necessary for the lease to be legally effective. The main benefit of registering the lease on a public register is to provide third parties with notice of the tenant's leasehold interest in the property.

BASIC TERMS OF COMMERCIAL LEASES

Term

There is no minimum or maximum term for a commercial lease. The duration of the lease term can be for any number of years or up to a fixed date.

However, retail leases (relating to leasing of shop space in shopping centres) are governed by specific legislation and, in most jurisdictions, retail leases have a minimum term, inclusive of options for renewal included in the lease (or agreement for lease), of five years (unless the tenant agrees to waive that right).

Dates

There are a number of dates that appear in leases:

- **Execution date:** this date appears on the page that requires execution by the parties to the lease. It signals the date on which the parties executed the agreement and if the agreement is executed by the parties separately, the date the first party executed the agreement is noted as the execution date.
- **Commencement date:** this date is a critical date in the lease because it reflects the date the tenant may commence its exclusive possession of the premises. Often in a situation where the existing tenant is still in occupation or the building of the leased premises has not yet been erected, the parties may enter into an agreement for lease prior to entering into the lease. In the agreement for lease, the commencement date is usually defined and may not be a fixed date. It may rely on the date in which fit outs or developer's works have completed.
- **Expiration date:** the date on which the term of the lease expires, unless sooner determined.

Space

Leases usually refer to two areas of space – the leased premises and the common areas of the building.

Leased premises are typically described by attaching a plan of the premises as an annexure to the lease. The authorities in each Australian jurisdiction that control the registration process of leases may have specific requirements in relation to the annexure of plans to leases, which may need to be strictly adhered to for successful registration of the lease. For example, when only part of a building is being leased, some authorities require an accurate description of the part of the building being leased in addition to a certain type of plan.

However, in situations where the leased premises is of the entire property or building, description of the leased premises presents relatively little difficulty, whether it comprises only a building or land and improvements. The leased premises then comprise the whole title and a specific plan may not be required, depending on the Australian jurisdiction.

Common areas are the areas where the tenant will not have exclusive occupation and access to on a property or in a building. These areas may be used by a variety of other tenants and even the public. Some examples include lobbies, parking lots, pathways, hallways, utility shafts, conduits, elevators and rooftops.

Measurable space

The measurable space of the leased premises is of particular importance for the calculation of the rent payable when the premises are initially leased and upon rent review, and also for the calculation of the proportion of the operating expenses (called outgoings) attributable to the leased premises. Often, premises are leased on a rent per square metre basis.

There are some established methods of measurement published by certain bodies such as the Property Council of Australia, which have gained wide-ranging acceptance in the industry.

Rent and expenses

The lease needs to establish the rent payable for the lease term, which is usually an amount paid generally on a monthly basis (but sometimes on an annual basis). The lease should provide details of where, to whom and how rent should be paid and also provide for interest to be charged on any unpaid or late payments of rent.

It is common practice for leases to contain a clause providing for annual rent reviews. Such clauses tend to account for inflation and movements in the average market rent.

It is also common for leases to include a clause allowing for the abatement of rent in situations where the premises are destroyed or seriously damaged or are rendered unusable for a period of time. Without this clause, the risk of potential liability for rent when the premises cannot be occupied and used by the tenant would equate to considerable expense for the tenant. Such abatement clauses are critical for the protection of the tenant's interests.

The rent payable to the landlord can consist of a variety of obligations.

Base or fixed rent

This is usually a set amount that may change or increase according to various modes, including fixed annual increases, determination by an expert, by arbitration or valuation, or variation according to Consumer Price Index.

Turnover rent/percentage-based rent

It is also common practice in retail leases for landlords to charge a percentage of the tenant's profit in addition to base rent.

Operating expenses

The tenant is often obliged to pay for certain costs of the landlord operating, maintaining and repairing the building. When there are multiple tenants, each tenant pays its proportionate share of those costs. It is common practice for the costs to be charged to the tenant per square metre of the measurable space leased by that tenant as a proportion of the landlord's total lettable premises.

Taxes

Goods and Services Tax (GST) (see Chapter 3 for more) must be charged on the supply of a commercial lease as it is deemed a taxable supply. The current rate of GST charged on taxable supplies of goods and services is 10%. The landlord will need to charge GST on the rent and other consideration received from the tenant and will then need to remit the GST received from the tenant to the Australian Taxation Office.

In the case of commercial leases, tenants that are registered for GST are entitled to claim tax credits for the GST that they pay on the rent and other considerations to the landlord. However, this is subject to suitable provisions in the lease and also subject to the landlord being registered for GST.

Also, it is general practice that the tenant should pay for any stamp duty and registration fees payable in relation to the lease. A detailed explanation of the application of stamp duty legislation to leases is beyond the scope of this guide. It should be noted, however, that in most jurisdictions stamp duty on leases was abolished, subject to limited exceptions. Some of these exceptions include leases on which a premium is paid on transfers, surrenders and other dealings in connection with leases.

ADDITIONAL CONCEPTS IN COMMERCIAL LEASES

Incentives

It is common, subject to market conditions, for landlords to provide tenants with a financial incentive at the commencement of the lease. The level of the incentive will be dictated by the market at the time, with the amount usually taken as an initial rent free, a rent abatement amortised over the term of the lease, a fitout contribution or as a combination of the same. Incentives are often contained in separate incentive deeds, and not the lease itself, so as to keep the details of the incentive confidential (ie the incentive deed, unlike the lease, will not be registered on title).

Transfers

A tenant is able to transfer its leasehold right to occupy the real estate to a third party through an assignment of the lease to a third party or a sublease of the existing lease to a third party as a subtenant.

An assignment of the lease involves transferring the benefit of the landlord's obligations under the lease and renders the assignee liable under the lease.

Alternatively, where the lease provides for it and with the landlord's consent, it is possible for a tenant to sublease the existing lease to a subtenant.

Options to renew

It is common for a lease to contain an option for the tenant to renew the lease for an additional term, however this must be negotiated between the parties. Usually the tenant is provided a certain time period prior to the expiration of the lease term to notify the landlord that they wish to exercise the option to renew the lease for an additional term. Generally, the failure to exercise an option for renewal within that time period will result in loss of the option for the tenant.

Insurance

In relation to the cost of insuring the improvements of a building, the landlord of a lease will generally be responsible for taking out such insurance (but would normally pass on the cost to the tenant in the form of outgoings).

The tenant will normally be responsible for obtaining the necessary insurance policies (such as public liability insurance) for the leased premises pursuant to their lease obligations.

Defeasibility

Generally, once the tenant's leasehold interest is registered on the public record, this is sufficient notice to incoming purchasers and mortgagees of the tenant's interest in the property. As discussed above, and depending on which Australian jurisdiction is applicable, the tenant will be required to register the lease on the public record if the lease term exceeds three years.

Services

Tenants under commercial and retail leases tend to arrange and pay for their own utilities and telecommunications directly from the suppliers where they are able to obtain a separate connection. Otherwise, the landlord can arrange to supply the utilities and telecommunications and on-sell these services to the tenant.

Use

Most leases will specify the permitted uses of premises. Certain activities that may cause a nuisance are prohibited and tenants are also subject to any usage restrictions laid down by the planning regulations. However, such usage restrictions may vary between local planning authorities within Australian state jurisdictions.

Fit out and tenant's works

When a lease or an agreement for lease is signed by the parties, the premises often require some work to be completed before the tenant may open for business. Sometimes the building itself requires additional work or may not even exist at the lease execution. The parties may enter into an agreement for lease to set out the essential terms until the lessee is able to move into occupation.

The agreement for lease may set out the terms of the fit out, the tenant's works, approvals for the tenant's works, the commencement date (which may depend on the completion of the works) and any fit out incentives provided by the landlord (in some situations, the landlord may provide monetary incentives towards fit outs of the lease premises).

Default and remedies

Typical defaults on the lease include the tenant's failure to pay rent, the parties' failure to perform lease obligations, abandoning the premises and transferring tenant's interest without the landlord's prior approval.

Where there has been a default of the lease, parties may be able to seek remedies in the form of recovery of rent, damages and recovery of possession (eg the landlord's physical re-entry).

RETAIL LEASES

In most Australian jurisdictions, there is specific legislation governing retail leases, which provides for specific requirements of parties to the retail lease. Generally, most jurisdictions will require an assessment of whether the lease of the property falls within the category of retail shops and stores defined within the legislation, which will then dictate whether the lease falls within the ambit of such legislation.

The consequences are that some preliminary steps need to be taken before entering into a retail lease, such as the requirement that the landlord provide a disclosure statement to the potential tenant at least seven days before a retail shop lease is entered into.

It has also been accepted as a general principle in most jurisdictions that the minimum term for which a retail lease should be entered into by a new tenant, inclusive of options for renewal included in the lease (or agreement for lease), is five years. However, in some jurisdictions it is possible for the tenant to waive this minimum term.

In relation to rent, in some jurisdictions there is a prohibition against changing the base rent more frequently than once every 12 months. It is also common for such legislation to require confidentiality of information relating to turnover provided by the lessee for the purposes of turnover rent.

Restrictions on trading hours and the ability to trade within or beyond those restrictions are important for retail shops. Generally, such legislation will also provide guidance on trading hours, including how trading hours of the retail shopping centre may be changed.

It should be noted that the retail leases legislation varies from state to state, often substantially, so expert advice should be obtained by parties before entering into a retail lease.

POINTS TO NOTE

- Mostly state- and territory-based common law and statute govern leasing in Australia.
- Commercial leases comprehensively deal with all aspects of the landlord and tenant relationship.
- Leases always include the term of the lease, rent review mechanisms, key dates, method of payment of rent, operating expenses and taxes, termination rights and make good.
- Retail leases are covered by specific legislation in most state and territory jurisdictions. In most cases, this requires formal preliminary steps be taken before entering into a retail lease.

CONSTRUCTION

In Australia, the main sources of law that govern and regulate contracts on design and carrying out building works are:

- Contract Law: the law that governs agreements and arrangements between parties
- Law of Tort: the law that addresses, and provides remedies for, civil wrongs not arising out of contractual obligations
- Legislation: various statutes and subordinate legislation (regulations, orders etc) that govern the carrying out of construction operations
- Breach of Statutory Duty: failure to carry out duties or to fulfil obligations imposed by legislation. An injured person may make a civil claim if they have suffered injury as a result of the breach (unless specifically excluded in the statute itself)
- Law of Restitution: the area of law concerned with the award of remedies, which have one common function – to deprive the defendant of a gain, rather than to compensate the claimant for loss suffered
- Law of Restitution – Criminal Law: sanctions imposed for acts and omissions that constitute criminal activity under Australian law.

CONTRACTS

Standard form contract

Inadequate contracting is one of the major causes of disputes in the building and engineering industry. Standard Form Contracts (SFCs) redress this by introducing a measure of standardisation and consistency.

SFCs are commonly used in Australia by large employers (to incorporate detailed special conditions to address project and risk requirements and specific commercial drivers) and by most government agencies that procure infrastructure.

However, SFCs are not used for forms of delivery such as:

- Alliance contracting
- Public-Private Partnerships (PPPs)
- Hybrid forms (eg “Early Contractor Involvement”).

These contracts are prepared on a project-by-project basis. Some agencies that use these methods of procurement frequently will tend to use the same form of contract repetitively.

Although there are no standard form contracts in PPPs, a large body of market precedent has developed in the Australian PPP market, lending some consistency to the positions adopted by both the public and private sector.

International forms

International forms of contract are rarely used in Australia.

Terms implied into contracts

Whether or not a contract contains certain terms, they may be implied into construction contracts under state and territory legislation.

Implied payment terms

A contract must include an adequate mechanism for determining what payments become due, when they become due and a final date for payment.

A builder is generally entitled to:

- Receive payment by installments, stage payments or other periodic payment
- Suspend performance for non-payment.

If the contract does not make adequate provision, the provisions of the statutory scheme will apply automatically.

Implied warranties as to work standards

A term will be implied into the contract (if not already contained in the contract) requiring the contractor to perform the work with all proper skill and care. Breach of this duty includes the use of materials containing patent defects.

Additionally, the contractor must use materials that are reasonably fit for the purpose for which they are to be used (whether or not that is a purpose for which the materials are commonly supplied) and of good quality.

INFRASTRUCTURE IN AUSTRALIA

Public procurement: PPPs

There has been a surge in delivery of major infrastructure projects through the PPP model. It is estimated that federal and state governments plan to deliver over AU$400 billion of infrastructure projects in the next 10 years, at least 15% of which are likely to be delivered on a PPP basis.

A PPP is defined by the Federal Government as a procurement involving the use of private sector capital to wholly or partly fund an asset (which would have otherwise been purchased directly by the public sector) and that is used to deliver public sector outcomes.

Each state government has its own PPP policy. The various policies:

- Require the preparation of a number of rigorous and detailed business cases and assessments at each stage of the delivery of a project
- Require market testing at the procurement stage through a competitive tender process between the various private sector participants (usually structured as consortia in the form of a special purpose vehicle with interest by the financier, builder, designer, operator and maintenance contractor)
- Impose some form of value for money test
- Are intended to be flexible enough to apply to different types of infrastructure while acknowledging that the market may be more receptive to certain kinds of PPP projects than others.

OBLIGATORY REQUIREMENTS

Residential licensing and permits

Many states and territories now have legislation requiring residential builders to:

- Be licensed
- Comply with statutory warranties in relation to building work quality
- Comply with detailed requirements on the form and content of the residential building contract.

Commercial licensing and permits

In general, the following requirements apply to non-residential construction in each state or territory:

- There is a requirement to be registered or licensed as a builder in the relevant jurisdiction before building work can be carried out. In some cases the registration is personal, that is, it attaches to an officer of the contractor. In some cases, the requirement to be registered extends to project and construction manager-type roles.
- Restrictions are imposed on using the word "builder" and there is a requirement that building work be "supervised" by a person who is registered.
- In most jurisdictions, persons who carry out specialised work such as plumbing, gas fitting and electrical work must hold the appropriate licence or registration.
- In some states, a timeframe within which any litigation connected with a building dispute may commence is imposed.
- In some cases, there is an obligation to take out and maintain certain types of insurance (eg commercial builders must take out structural defects insurance in Victoria).
- Many jurisdictions have established statutory bodies, which monitor compliance with the licensing and registration regimes.

Particular activities are also subject to specific regulations and licensing across Australia, including working at heights, working with asbestos, welding, demolition, excavation, cranes and scaffolding.

Penalties such as fines or loss of registration/licence are imposed on parties which contravene the requirements.

Health and safety on construction sites

Each jurisdiction has a principal Work Health and Safety (WHS) Act, which imposes general health and safety duties. These duties are performance-based obligations rather than highly prescriptive requirements.

The primary WHS Act in each jurisdiction is supported by regulations and Codes of Practice applicable to particular industries or activities. Due to the high risk of serious injury, the infrastructure industry and many activities within it are subject to tight statutory regulation.

Each jurisdiction requires the appointment of a 'principal contractor' under the relevant WHS Act who must 'so far as is reasonably practicable', ensure the health and safety of persons affected by construction work. The test to be applied is an objective one. In order to gauge what steps are "reasonably practicable", the principal contractor must conduct itself in accordance with generally accepted risk management principles. These include the need to balance:

- The likelihood of the hazard or risk occurring and the degree of harm that would result if the hazard or risk occurred
- The knowledge of the hazard or risk and the ways to eliminate or reduce the hazard or risk
- The availability and suitability of ways to eliminate or reduce the hazard or risk and the cost of eliminating or reducing the hazard or risk.

Failure to comply with WHS obligations leaves the person or company responsible liable to criminal prosecution.

Water and waste

Water quality is protected by water-related state Acts and Regulations, which control issues such as pollution, surface water, groundwater and discharge to sewers.

A wide range of duty of care legislation controls the generation, transportation and disposal of waste. Every business is legally obliged to ensure its waste is handled and disposed of safely. State environmental protection legislation requires that commercial construction projects have a site waste management plan, to be kept updated throughout the project

Environmental impact assessments

Under state local planning legislation, a construction project likely to have a significant effect on the environment by virtue of factors such as its nature, size or location may require an environmental impact assessment before planning permission is granted.

Sustainable development

Energy efficient buildings are becoming an increasing focus for the governments, developers, investors, builders and prospective tenants.

A number of green rating schemes currently operate in Australia across a range of development types. The two most prominent are:

- The Green Star rating scheme operated by the Green Building Council of Australia
- The National Australian Built Environment Rating System administered nationally by the New South Wales Department of Environment and Climate Change (NABERS).

Green Star is a national and voluntary environmental rating scheme that evaluates the environmental design of buildings at a conceptual stage and at an as-built stage. It assesses a building's potential to reduce its environmental impact. It does not assess a building's operation.

NABERS is a performance-based, voluntary rating system for existing commercial office buildings and hotels. It rates an existing building on the basis of its measured operational impacts on the environment.

Construction projects must also meet the sustainable development objectives contained within the relevant regional/area development plan.

LIABILITY

Developer's liability to end user

With regard to the liability of the land developer procuring the works to the end users of the building, it is often the case that the development agreement will limit liability for the design and construction of the works to a stipulated period (usually ending on the expiry of the defects liability period under the building contract for the development, but depending upon the developer, the nature of the project and the stage in the economic cycle, sometimes for considerably longer than this period) after completion of the works – except either for claims that have been issued or where the intention to make a claim in respect of accrued and identified rights of action has been notified to the developer before the expiry of the period.

Other liability to end user

In a typical development project, there is usually no contractual relationship between the parties employed in connection with the design and construction of the development (the architect, engineers, other consultants, main building contractor and sub-contractors) and the end users of the completed building.

In such a case, assuming the subsequent owner does not have the benefit of any contractual warranties from the previous owner, the subsequent owner will need to rely on the law of negligence.

Over the last 20 years, Australian law has come to recognise that building owners who suffer loss because of defective building may have a cause of action against negligent builders and others, including municipalities who by negligent exercise of their statutory responsibilities (eg inspecting foundations) allowed defective building to take place.

An action in negligence offers a subsequent owner a right of recovery against the builder of, or a relevant consultant associated with the construction of a building in circumstances where the subsequent owner suffers a particular kind of "economic loss". That is, the diminution in the value of the building in that the plaintiff has acquired property of less value than was reasonably believed, and which required the expenditure of money to restore it to the contemplated standard.

It is also possible for end users to require the main construction parties to provide them with separate collateral warranty agreements or "third-party rights". Such collateral warranties however often contain exclusion and limitation clauses, which restrict the damages that an end user can recover.

It is unlikely that a contractual exclusion in favour of a builder, which has the effect of excluding or modifying any duty of care between the builder and previous owner, would operate to discharge the builder from a duty of care that would otherwise exist to third parties to the contract. This is because the builder's duty of care in such circumstances is imposed by law. However there would be difficulty in holding that a builder owes a duty of care to avoid causing economic loss to a subsequent owner if performance of the duty would have required the builder to do more or different work than the contract with the original owner required or permitted.

INSURANCE

In Australia, some types of insurance are required to be taken out by statute for infrastructure projects. In addition, other types of insurance are taken out as agreed by the parties to a contract, depending on the nature of the works and the requirements of those involved in the project.

Statutory insurances

There are four main types of required insurance relevant to infrastructure work:

- Professional indemnity insurance, which must be taken out by any person providing professional services in respect of construction or infrastructure work. This would cover architects, engineers, building surveyors and project managers providing services on infrastructure projects (only required in some states).
- Residential building legislation requires a domestic builder to take out a policy covering limited defects and non-completion insurance (the Northern Territory and Queensland do not have this legislative requirement).
- Workers' compensation insurance, which covers most liabilities for death or injury to employees.
- Third-party motor vehicle insurance, which covers third-party injury liability arising out of the use of a motor vehicle.

While in most states the statutory obligation to take out defects or warranty insurance is confined to residential builders, in Victoria legislation also requires commercial builders to take out insurance against structural defects and certain kinds of other builders (for example demolition contractors) to take out public liability insurance on specified terms.

Insurance by agreement

The main types of insurance that you may be required to take out under an infrastructure contract are:

- Public liability: covering liability for death, personal injury to any person, damage to third party property or other liability to pay compensation arising out of the works or project.
- Contract works: covering physical damage to the works, materials, plant, equipment and temporary structures.
- Property damage: covering damage to, physical loss or destruction of all property belonging to the insured (not including the contract works).
- Business interruption or advanced loss of profits: covering consequential or pure economic losses, including gross profits resulting from an interruption or interference with business if an insured asset is damaged. Insurance can also be obtained for advanced loss of profits (where the business has not yet commenced).
- Marine cargo: if the works include the provision of significant items from offshore, there may be a requirement to take out marine cargo and other goods insurance.

Project-specific insurance may also be required.

SECURITY OF PAYMENT

Each Australian state and territory has legislation dealing with Security of Payment (SOP) for contractors, suppliers and subcontractors in the infrastructure industry.

While the detail varies from state to state, the SOP legislation has the following features:

- It enshrines a statutory right to payment for infrastructure work and services. In some jurisdictions, this right is granted even if there is a similar existing right in the relevant infrastructure contract. In other jurisdictions it is only granted if the relevant contract contains no payment regime.
- It specifies a process that must be followed by both the party claiming under that statutory right, and the party who is liable to make payment.
- It prohibits "pay when paid" clauses and other clauses considered adverse to a contractor's right to be paid for work carried out.

- It prescribes a type of fast track dispute resolution in the form of adjudication of payment claims under contracts.

Some SOP Acts (such as those enacted in the Northern Territory and Western Australia) give a party a right to claim payment in respect of the work or services only if the relevant contract does not contain any provision for payment.

In other SOP Acts, notably those in Victoria, New South Wales and Queensland, the statutory right exists regardless of the presence in the applicable contract of provisions giving a right to a party to claim payment for work and services. This statutory right sits in parallel with the contractual right to payment.

Depending on the jurisdiction in which the works are being carried out, most construction and infrastructure contracts need to contain provisions for dealing with SOP.

Such provisions will not be standard, as careful consideration needs to be given to the nature of the project and how the payment provisions are intended to work. For example, in some jurisdictions, imposing a pre-condition on payment of a contractor or subcontractor, such as the provision of insurance details or security, may be in breach of the relevant SOP Act.

Not all construction work is covered by the relevant SOP Act. Notable exclusions to the operation of the SOP Act in most jurisdictions are mining work, residential building work and work where the payment under the contract is not the value of the work performed but some other mechanism (as may be the case in a build own transfer project or project alliance).

In some jurisdictions, legislation still exists that gives contractors a right to place a charge over monies payable to the contractor (in the case of Queensland) or a lien over property to secure payment (in the case of South Australia).

HANDLING DISPUTES

In court

Unless the parties specifically agree to refer a dispute to arbitration, a claim must be pursued in a court. Courts operate at both federal and state government levels in Australia. In most cases, the jurisdiction of a court is governed by the amount in dispute or, in the case of the Federal Courts, the subject matter of the dispute. In Australia, the highest level court in each state (the Supreme Court) has inherent jurisdiction to resolve a dispute. Decisions can be appealed. The ultimate court of appeal in Australia is the High Court of Australia.

In some jurisdictions, industry specific tribunals have power to hear disputes (for example, the Land and Environment Court in New South Wales).

Arbitration

Arbitration is regulated in each state in Australia by domestic arbitration legislation (known as the uniform Commercial Arbitration Acts). Arbitration is private – the outcome remains confidential and the awards handed down by an arbitrator are not published.

To initiate arbitration, parties must expressly agree to use arbitration as the means of resolving their dispute. This agreement usually takes the form of a clause in the project contract setting out an agreement to arbitrate any dispute that arises under the contract.

International arbitration

International arbitration is governed by the *International Arbitration Act 1974* (Cth) (IAA). The IAA provides that arbitration is international if any of the circumstances set out below apply:

- The parties to an arbitration agreement have their places of business in different countries.
- The place of arbitration determined in an arbitration agreement is outside the country in which a party's business is located.
- The place where the commercial obligations are to be performed is outside the country in which a party's business is located.
- The parties have expressly agreed that the subject matter of the arbitration agreement relates to more than one country.

Sydney and Melbourne operate as centres for international arbitration. International arbitrations are run on a similar basis to domestic arbitration.

Alternative dispute resolution procedure

Parties to a contract may also consider:

- Adjudication: designed to help parties obtain a speedy decision. Parties to construction contracts now have a statutory right to adjudication, whether or not there is a term in the contract.
- Mediation: requires the participation of a third party, a mediator, whose role is to assist the parties to a dispute to reach agreement on the resolution of that dispute.
- Expert determination: can be a useful alternative where the issue in dispute is narrow and specific.

POINTS TO NOTE

- Investors involved in the design and execution of building works should ensure they have adequate legally enforceable contracts.
- Formal requirements to be aware of include licensing and permits issued in the various states and territories.
- Work health and safety, water and waste control, and environment impact assessments are all relevant to development and construction of real estate.
- Certain construction work is covered by that state or territory's relevant Security of Payment Act, which enshrines contractors, suppliers and subcontractors with a statutory right to payment.

ENVIRONMENTAL
REGULATION AND DEVELOPMENT
APPROVAL

Environmental regulation and development approval continue to be material factors in real estate investment in Australia. As urban boundaries expand (such as in Melbourne's urban growth area), new residential subdivision and other developments unavoidably impact on areas affected by native vegetation, threatened species, ecological communities and Aboriginal cultural heritage. Similarly, urban consolidation in Australia's major cities often involves development on brownfield sites affected by historical contamination from previous industrial uses. Further, with the impacts of climate change and recent severe weather events, building controls are increasingly requiring developers to demonstrate that a proposed development can adequately respond to risks such as wildfire, flooding and sea level rise. Increasingly, developments are also being required to meet energy efficiency and sustainability criteria.

PLANNING LAWS

There are state- and territory-based planning laws that restrict and control the use, development and subdivision of land. Information on land use and development and control can be obtained from state or local government and is usually contained in a planning scheme or planning instrument applicable to each local government area and/or at state level. A planning certificate can also be obtained from state or local government authorities confirming land use, development and environmental controls that apply to a particular property.

The planning law may provide for any use, development or subdivision to be "as of right" (no further permission required), subject to permission (which may be discretionary or subject to certain mandatory requirements, or both), or in some states and local government areas, absolutely prohibited. There are generally appeal rights where the proposed use, development or subdivision is at the discretion of a planning authority. If a use, development or subdivision is prohibited under the planning law, that use, development or subdivision can only lawfully proceed if the planning law is changed (for example, through amendment to the relevant planning scheme or planning instrument that controls the use and development of the subject land).

HERITAGE

Federal, state and territory legislation can protect designated areas, places, buildings and objects from development, destruction or removal. The heritage controls are sometimes given effect in planning laws or they may also run parallel to them. Authorities responsible for heritage protection include local government, state heritage councils and the federal environment department, depending on whether the heritage building or place has local, state or national significance.

Protection of Aboriginal cultural heritage

Specific legislation protects places and objects of cultural significance to Aboriginal and Torres Strait Islander people. It may be necessary to investigate whether legislation of this sort is applicable where developments concerning land are proposed, particularly in areas where there may be a strong Aboriginal or Torres Strait Islander community. The legislation provides for a variety of mechanisms ranging from complete protection from development by declaration (usually by a government minister), as well as lesser forms of protection (eg consultation and management strategies).

ENVIRONMENTAL LAWS

Protection of the environment is a major priority in Australia, and environmental issues receive a great deal of media and public attention. Australia has had a strict system of federal and state environmental regulations prohibiting the discharge of pollution and waste to air, water or land. Recently, an improved range of regulatory mechanisms involving more flexibility has allowed for a spirit of cooperation between business and government to promote corporate sustainability. There are increased opportunities for industry to interact directly with government authorities to plan targets for energy and resources use, waste control and disposal. Product stewardship legislation, which provides the framework to effectively manage the environmental, health and safety impacts of products, and in particular those impacts associated with the disposal of products. The framework includes an industry-led national scheme for recycling televisions and computers.

Each state and territory has its own environmental legislation and administration, and its own regime for town planning, control of pollution, clearing vegetation and the use and extraction of resources, including water. The principles in each jurisdiction's legislation are similar, but there are important differences that need to be carefully considered in the particular state and territory. In most states, the body with responsibility for environmental administration (including compliance and enforcement) is known as the Environment Protection Authority. There are some environmental issues, for example water, where a coordinated national approach to ecologically sustainable development has been undertaken by all tiers of government.

Approval requirements vary between the different state, territory and local governments responsible. Commonly, approvals are required before particular land uses are commenced, buildings constructed, or before certain types of plants may be installed and environmental impact assessments may be required as part of the approval process. Approvals often need to go through a public notification and comment stage. The *Environment Protection and Biodiversity Conservation Act 1999* (Cth) may also apply if there are matters of national environmental significance, for example world heritage, protected wetlands, or threatened species of flora or fauna.

Licences will generally be required for activities such as waste discharge, and the disposal, treatment, storage and use of certain quantities of chemicals. Any process that involves the production of pollution will be subject to stringent works approvals and licensing requirements administered by the environment authorities in each state. Each state and territory has different approaches to statutory requirements to report pollution incidents and contaminated land and who is responsible for reporting.

Failure to comply with environmental and planning legislation may lead to civil and/or criminal liability. Penalties may include both fines and jail, along with loss of licences and liability for clean-up costs. A company convicted of environmental offences may find itself the subject of adverse publicity. There has been a growing trend to impose substantial financial penalties and, in certain circumstances, directors and managers may be held personally liable for offences committed by a company.

CLIMATE CHANGE POLICY AND BUSINESS

Changes in climate mean that long term environmental impacts on development need be considered and taken into account when making long-term commitments. Climate change adaptation (ie, adapting to the impacts of climate change on land use), is dealt with variously under land use planning legislation in most of the states and territories. This is done through either mandatory consideration of climate change in terms of addressing the natural hazard impacts or through the application of the principle of ecologically sustainable development, or ESD. ESD pervades much of the environmental related legislation in Australia. For example, environmental and natural resource management agencies are commonly directed to take into account ESD in decision making. Recent legislative reforms however, indicate that despite ESD increasingly becoming a principle of international law, in Australia, the requirement to take into account ESD and the impacts of climate change is likely to be absent from future state planning legislation in an attempt to encourage the fiscal aims of economic development. Nevertheless, statements from the insurance sector and recent increases internationally in claims against organisations for failing to take into account the impacts of climate change puts greater impetus on corporations to consider their climate risk.

ENERGY EFFICIENCY AND GREEN BUILDINGS

At the federal level, the Energy Efficiency Opportunities Scheme, which is aimed at improving energy efficiency, requires certain corporations to identify, evaluate and report publicly on cost-effective energy savings opportunities.

Recent legislation also requires owners of certain commercial office buildings to disclose energy efficiency performance data to prospective buyers and tenants when space is offered for sale, lease or sublease. In relation to green buildings, the Building Code of Australia sets out energy efficiency requirements for new buildings and major refurbishments. Many new buildings are demonstrating their green credentials by achieving Green Star ratings from the Green Building Council of Australia.

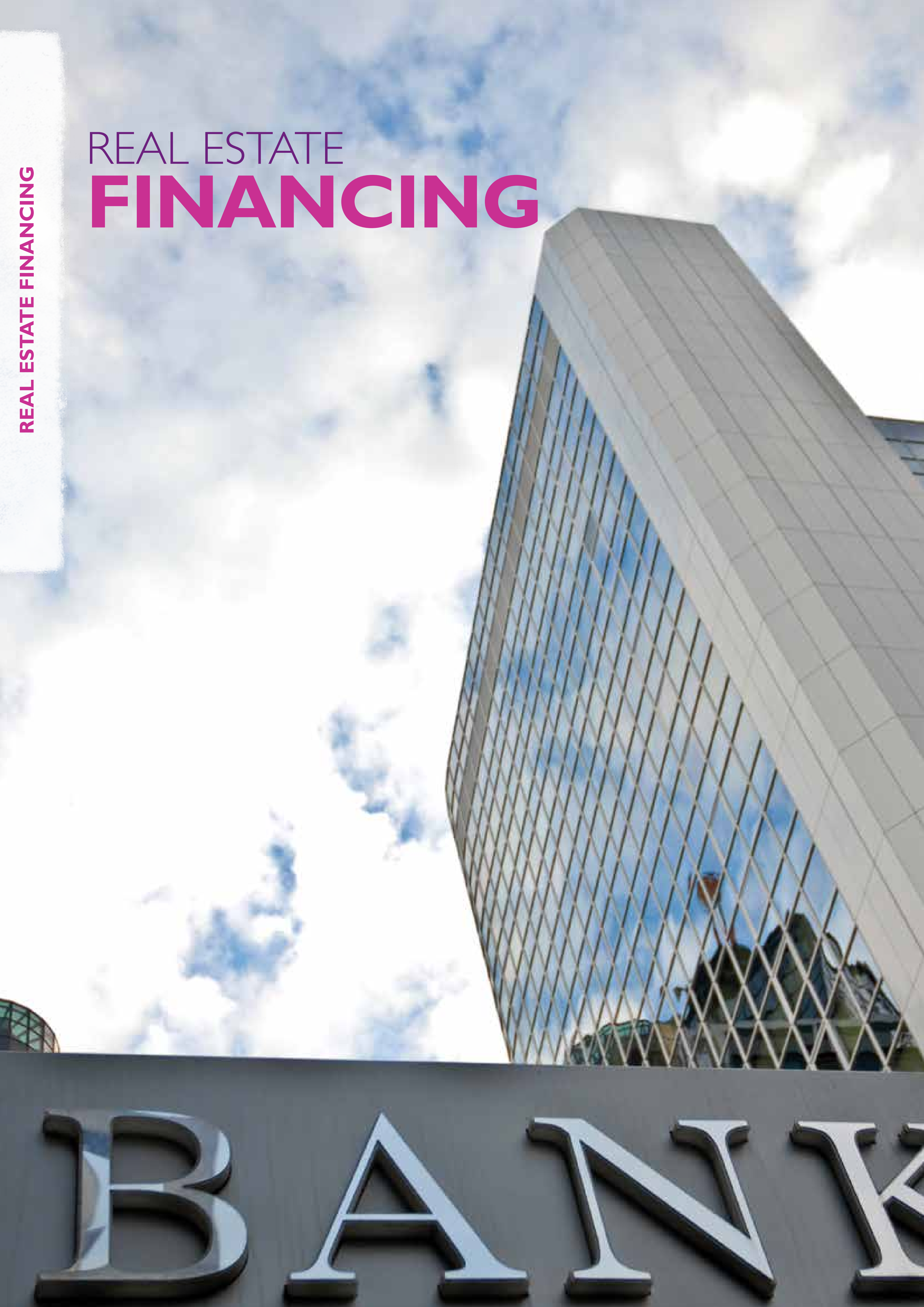
There is also state-based regulation demanding sustainability considerations in new buildings as well as local government requirements through planning controls requiring sustainability and energy efficiency plans to be prepared as part of a development application. For example, in NSW there is a program known as the Building Sustainability Index (BASIX), which assesses a residential building's energy efficiency and water reduction achievements. The design must meet minimum targets before a BASIX Certificate can be issued. Every development application for a new home or residential flat building must be submitted to the relevant local council with a BASIX Certificate.

POINTS TO NOTE

- Investors should be aware of the various federal, state and territory laws around planning, the environment, heritage and Aboriginal culture.
- Organisations should take into account the impact of climate change on long term commitments and consider the climate risk associated with decisions.

REAL ESTATE FINANCING

REAL ESTATE FINANCING



Australia has an established and well-developed market for real estate finance. A range of banks, non-bank lenders and specialist financiers provide debt financing for the acquisition and development of real estate.

FINANCING TERMS

One of the first steps in obtaining financing is to obtain an independent valuation of the relevant land. This forms the basis of the lender's maximum loan-to-value ratio, which in turn determines the amount of equity that the borrower will need to contribute to the transaction. The lender will also usually want to undertake a level of due diligence in relation to the land, and the agreements and approvals relating to its purchase and intended development.

Where financing is required to fund the construction of a building such as an office tower or an apartment complex, the lender typically only allows the borrower to draw down the loan progressively subject to the satisfaction of conditions precedent. These conditions include confirmation that the building program and budget are on track, that the funds available to the borrower are sufficient to meet the cost to complete construction, that the expected completion date for construction is within the agreed timetable and that the appointed quantity surveyor has signed off on the actual and projected construction costs and the expected completion date. The lender may also only allow further drawings to be made if at each stage a sufficient number of floors in the office tower have been leased or apartments have been sold.

SECURITY

Commercial loans that are provided for the purpose of acquiring or developing land are typically secured. This involves the lender taking a mortgage over the land. The lender also usually takes security over some or all of the other assets of the borrower. In the case of freehold land, the mortgage is registered at the land titles office in the relevant state or territory. The advantage of registration is that it confers a clear priority on a mortgagee according to when the mortgage is registered on the landowner's title. All real estate mortgages typically confer a power of foreclosure, power of sale and power to appoint a receiver.

In the case where the borrower only has a lease, if the lease is registered then the mortgage of lease can also be registered at the same land titles office. A mortgage of an unregistered lease cannot be registered. If a lender is taking a mortgage of lease it may also want to enter into an agreement directly with the landlord. This agreement would record the landlord's consent to the mortgage and would usually require the landlord to notify the lender of defaults under the lease and give the lender the opportunity to cure defaults in order to avoid the landlord terminating the lease.

MEZZANINE FINANCE

A second layer of debt financing is sometimes obtained for a real estate acquisition or development. Typically a bank would provide the majority of the debt financing against the security of a first-ranking mortgage over the land. Another bank or specialist financier might provide additional debt financing, albeit at a higher cost, which is secured separately over the same land by a second-ranking mortgage. It would be usual for the parties to enter into a priority agreement to regulate the priorities and enforcement rights of the two lenders. A subordination agreement might also be entered into if payments to the second mortgagee are to be restricted or prohibited while the borrower owes money to the first mortgagee.

POINTS TO NOTE

- Australia boasts a well-developed real estate debt finance market.
- Security on a non-recourse or limited recourse basis is common for debt finance raised for investment in existing tenanted real estate.
- Before granting finance, a lender will typically require an independent valuation of the land and undertake a due diligence process or request reliance on the investor's due diligence.
- Commercial loans provided to acquire or develop land are typically secured by the lender taking a mortgage over the land, and usually security over some or all of the other assets of the borrower.
- Occasionally and – in recent times – increasingly, a second layer of debt financing, known as mezzanine financing, is obtained mostly from non-bank sources at a higher cost to facilitate refinance of assets or developments.

USEFUL SITES

DLA Piper REALWORLD www.dlapiperrealworld.com
Provides investors, developers and end users with the answers to legal questions they typically have when entering foreign markets.

AusIndustry www.ausindustry.gov.au
Provides incentives to foster innovation and investment.

Austrade www.austrade.gov.au
The website of the Australian Trade Commission.

Australian Bureau of Statistics www.abs.gov.au
Australian statistics for a range of indicators.

Australian Competition and Consumer Commission www.accc.gov.au
Information about competition and fair trade.

Australian Customs www.customs.gov.au
Customs procedures and requirements.

Australian Securities and Investments Commission www.asic.gov.au
The website for Australia's corporate regulator.

Australian Securities Exchange www.asx.com.au
The operator of Australia's national stock exchange.

Australian Taxation Office www.ato.gov.au
Australian taxation information.

Australasian Legal Information Institute www.austlii.edu.au
Australian legal information.

Business Entry Point www.business.gov.au
An online resource for businesses.

Department of Education, Employment and Workplace Relations www.deewr.gov.au
Information on Australian employment and workplace issues.

Department of Sustainability, Environment, Water, Population and Communities www.environment.gov.au
Australian legislation, programs and policy.

Department of Immigration and Citizenship www.immi.gov.au
Australia's visas and immigration system.

Foreign Investment Review Board www.firb.gov.au
Examines proposals by foreign entities to invest in Australia.

Government Entry Point www.gov.au
Provides access to Australian federal, state, territory and local government sites.

IP Australia www.ipaustralia.gov.au
The administrator of Australia's intellectual property system.

Property Council of Australia www.propertyoz.com.au
Australia's commercial real estate peak industry body.

Tourism Australia www.australia.com
The gateway to Australian tourism.

Treasury www.treasury.gov.au
Information on Australian tax arrangements.

ABOUT DLA PIPER

With more than 600 lawyers globally, DLA Piper boasts the world's largest real estate practice and is consistently top-ranked around the world. As real estate develops into a truly global industry, the ability to quickly and efficiently provide legal services in structuring cross-border investments and transactions is paramount. DLA Piper clients value the team's global resources, regional strength and local delivery, and include private and public companies, institutional investors and government entities.

Within Australia, DLA Piper has a large team of lawyers in offices in five capital cities – Brisbane, Canberra, Melbourne, Perth and Sydney – with years of experience in the local real estate industry. They advise on issues affecting all stages of the property investment and development cycle, no matter what the jurisdiction. Additionally, many are active members of and contributors to the major business and industry associations, which have a key role in formulating policies and shaping the future of the Australian real estate industry.

In short, we offer one team with no borders, providing a real advantage to clients in Australia and beyond.

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