

# Regular research papers and articles providing sector specific insights and issues analysis – Property sector

December edition 2010 – Property

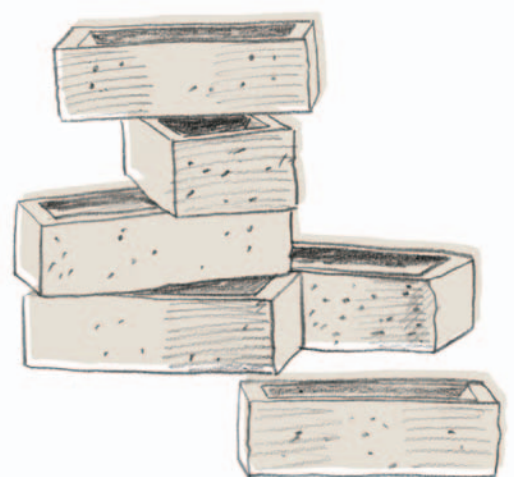
## Industry Intelligence Unit

Grant Thornton's Industry Intelligence Unit (IIU) blends the latest information and analysis of specific industries drawn from publicly available sources with pragmatic, commercial and practical initiatives to improve stakeholder value.

Welcome to our fifth property and construction IIU. Grant Thornton has increased its focus on the property and construction industry following the Global Financial Crisis (GFC), with a particular emphasis on flow-on effects and the post-GFC landscape.

This edition includes:

- A synopsis of the national residential property market, updated from the previous property and construction IIU
- A discussion of the current state of the residential property market with an emphasis on the capital cities
- The practical effects of the Building Energy Efficiency Disclosure Act 2010 (the BEED Act) on the sale and leasing of commercial office buildings
- A newsflash on the tax obligations of insolvency practitioners on formal appointments
- Case studies on dealing with asbestos issues on building sites, Occupational Health and Safety issues and the application of the margin scheme under the A New Tax System (Goods and Services Tax) Act 1999 (GST Act).



# Residential property update

Until recently the Australian residential market had experienced relatively high capital growth post-GFC (January 2009 onwards) when compared to other international markets (particularly the United States and the United Kingdom's residential property markets). However in the past six months, the growth in house prices in the capital cities has slowed appreciably.

Over the five year period ending July 2010, the national annual rate of growth in the residential property market has averaged 7.3%. However, this growth has not been a smooth upward transition, with periods of strong growth, modest declines and relatively flat appreciation.

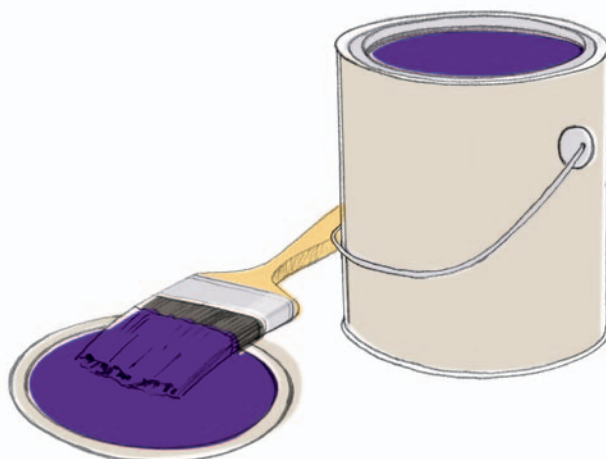
During 2008 at the height of the GFC, the value of residential property in the capital cities fell by 2.6%. Post-GFC capital city residential property values appreciated by 18.5% from January 2009 to May 2010. Whilst residential property has experienced strong price growth since the GFC, the growth in residential property values has not

been homogenous. Melbourne for example experienced a 26.1% increase in residential property values, while Brisbane experienced only 7.3% growth in the same period.

The following is a summary of the current drivers and restraints on growth in the residential property market:

Drivers	Restraints
<ul style="list-style-type: none"> <li>• Shortage of housing</li> <li>• Strong disposable income growth</li> <li>• Continuing low unemployment rate</li> <li>• Population growth</li> <li>• First home owners grants and stamp duty concessions</li> <li>• Record low rental vacancy rates</li> </ul>	<ul style="list-style-type: none"> <li>• Climbing interest rates</li> <li>• Housing affordability</li> <li>• Decrease in first home owners assistance</li> <li>• Rising consumer debt</li> <li>• Rising consumer default rates</li> <li>• Contraction in easy housing finance</li> <li>• Decrease in building approvals</li> </ul>

The most common view appears to be that the growth in housing prices will return to more sustainable levels with this trend continuing into 2011 after a period of strong growth post-GFC.

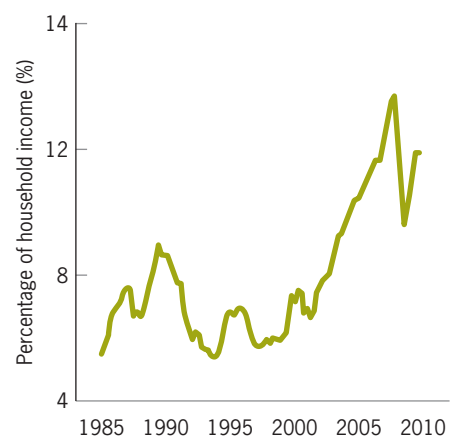


## Latest statistics

Borrowing for housing has moderated recently, but the increase in mortgage rates over the past year has resulted in an increase in the ratio of household interest payments to disposable income to 12% in the September quarter. This is below the peak of 14% reached in September 2008 as indicated in the chart below (Household interest payments). While household debt servicing is below its historical high it is still significantly above the average from 1985 to 2000.

## Household interest payments\*

Source: ABS; RBA



\*Excludes unincorporated enterprises. Income is before the deduction of interest payments. RBA estimate for September quarter 2010.

Despite the increase in debt servicing, housing loans in arrears have only increased slightly over the past year and remain less than 1% of the total stock of loans. Housing prices in the capital

cities fell modestly in the September quarter after a period of high growth of 1% per month throughout 2009 and in the early part of 2010. In comparing the growth in values of residential properties across major capital cities, Brisbane and Perth have declined most notably, whilst Sydney, Melbourne and Adelaide have remained relatively flat as indicated in the charts on the right (Capital city median dwelling prices and Dwelling prices).

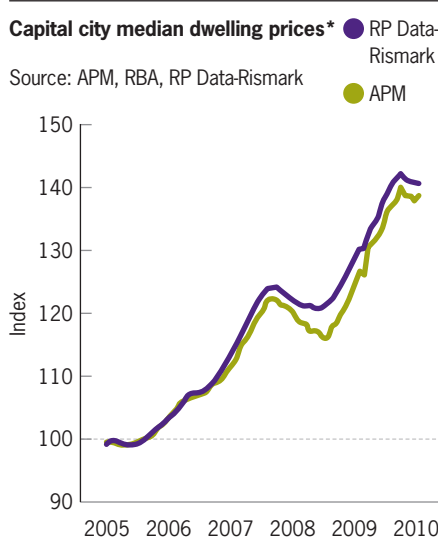
One of the main contributors to the slowdown in demand for housing stock, and therefore prices, has been the consecutive increases in the RBA's target cash rate in the past year and the increase in overseas funding costs experienced by financiers.

The table below highlights the increases in the RBA's target cash rate, in recent years.

Effective Date	Change in cash rate – Percentage points	Cash rate target – Per cent
3 Nov 2010	+0.25	4.75
5 May 2010	+0.25	4.50
7 Apr 2010	+0.25	4.25
3 Mar 2010	+0.25	4.00
2 Dec 2009	+0.25	3.75
4 Nov 2009	+0.25	3.50
7 Oct 2009	+0.25	3.25
8 Apr 2009	-0.25	3.00
4 Feb 2009	-1.00	3.25
3 Dec 2008	-1.00	4.25
5 Nov 2008	-0.75	5.25
8 Oct 2008	-1.00	6.00
3 Sep 2008	-0.25	7.00

Source: RBA

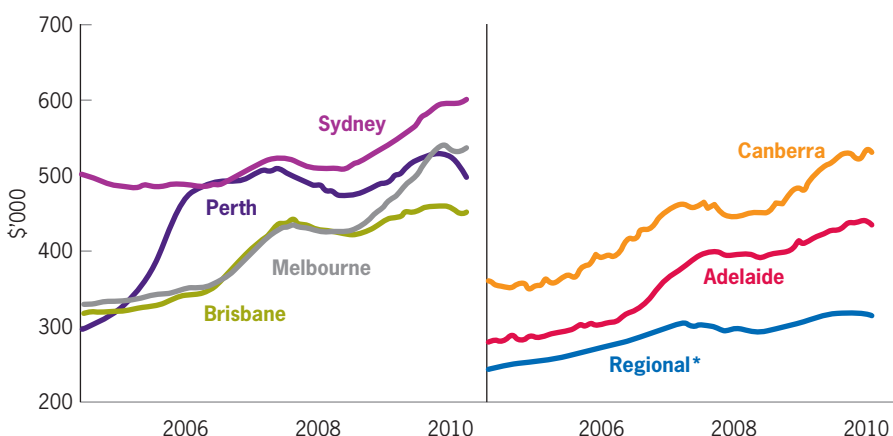
With increases in mortgage rates, housing finance activity has eased from its peak in late 2009 as you can see in the chart to the right (Value of housing loan approvals). The number of housing loan approvals has fallen dramatically following the expiration of the boost to the federal government's first home owners scheme.



\*Weighted average of houses and apartments. 2005 average = 100.

### Dwelling prices\*

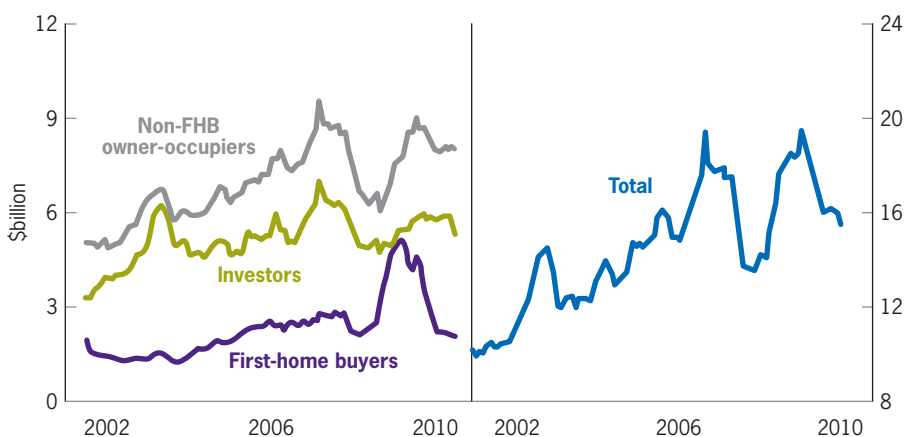
Source: RBA, RP Data-Rismark



\*Excluding apartments; measured as areas outside of capital cities in New South Wales, Queensland, South Australia, Victoria and Western Australia.

### Value of housing loan approvals\*

Source: ABS, RBA



\*Excludes owner-occupier refinancing, alterations and additions, investor approvals for new construction and by 'other' investors.

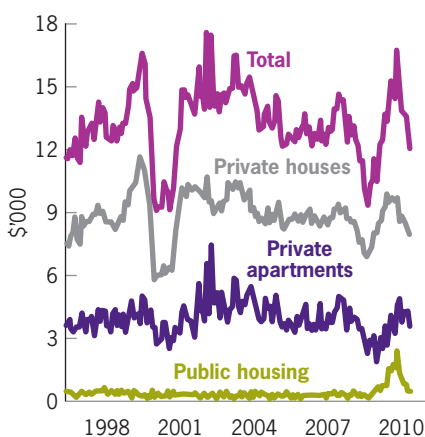
## Around Australia – Capital City Snapshot

Capital City	Summary
<b>Sydney</b>	<ul style="list-style-type: none"> <li>• Median house price is currently \$505,000</li> <li>• Since December 2008, house prices have increased by 18.4%</li> <li>• Since last year values have increased by 10.8%</li> <li>• In the three months to August 2010, dwelling growth values have slowed to 0.2%</li> </ul>
<b>Melbourne</b>	<ul style="list-style-type: none"> <li>• Median house price is currently \$470,000</li> <li>• Since December 2008, house prices have increased by 26.1%</li> <li>• Since last year values have increased by 13.6%, making Melbourne the best performing of all capital cities</li> <li>• In the three months to August 2010, dwelling growth values have fallen by 1.5%</li> </ul>
<b>Brisbane</b>	<ul style="list-style-type: none"> <li>• Median house price is currently \$434,000.</li> <li>• Since December 2008, house prices have increased by only 7.3%, well underperforming the other capital cities.</li> <li>• Since last year values have increased by only 2.1%.</li> <li>• In the three months to August 2010, dwelling growth values have fallen by 2.3%.</li> </ul>
<b>Adelaide</b>	<ul style="list-style-type: none"> <li>• Median house price is currently \$387,500</li> <li>• Since December 2008, house prices have increased by 10.7%</li> <li>• Since last year values have increased by 8.5%</li> <li>• In the three months to August 2010, dwelling growth values have fallen by 0.2%</li> </ul>
<b>Perth</b>	<ul style="list-style-type: none"> <li>• Median house price is currently \$460,000</li> <li>• Perth's residential market has not performed up to the level of its boom between 2005 and 2007. In fact, for the period from January 2009 to May 2010, Perth's growth rate of 10.4% was the second lowest (only underperformed by Brisbane) in the same period</li> <li>• Since last year values have increased by only 5.7%</li> <li>• In the three months to August 2010, dwelling growth values have fallen by 4.8%</li> </ul>
<b>Hobart</b>	<ul style="list-style-type: none"> <li>• Median house price is currently \$325,000</li> <li>• Since December 2008, house prices have increased by 12.8%</li> <li>• Since last year values have increased by only 4.8%, the lowest rate of growth for the past year</li> <li>• In the three months to August 2010, dwelling growth values have increased by 1.4%</li> </ul>
<b>Darwin</b>	<ul style="list-style-type: none"> <li>• Median house price is currently \$485,000</li> <li>• Since December 2008, Darwin has been one of the strongest performing capital cities with growth of 24.4%</li> <li>• Since last year values have increased by 12.5%</li> <li>• In the three months to August 2010, dwelling growth values have fallen by 1.4%</li> </ul>
<b>Canberra</b>	<ul style="list-style-type: none"> <li>• Median house price is currently \$480,000</li> <li>• Since December 2008, house prices have increased by 16.9%</li> <li>• Since last year values have increased by 10.7%</li> <li>• In the three months to August 2010, dwelling growth values have slowed to 1.2%</li> </ul>

Source: RP Data

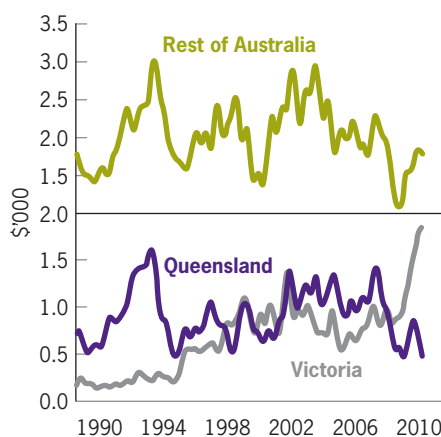
### Residential building approvals, monthly

Source: ABS



### Private apartment approvals, trend monthly

Source: ABS, RBA



The residential property markets in the capital cities of Australia are generally experiencing similar trends post-GFC. However, the increase in the values of residential properties across the capital cities has not been homogeneous, with some experiencing particularly strong capital growth whilst others have experienced weak to modest growth. The latest statistics suggest that the period of strong growth in median prices especially in Sydney, Melbourne and Darwin is over for the foreseeable future and a period of consolidation is occurring and set to continue into 2011.

Softening demand for housing stock has had a corresponding knock-on effect on private building approvals, which rose by 50% over 2009 but since late 2009 have fallen by 16%. Surprisingly, new apartment approvals in Victoria continue to be robust and experience solid growth in demand notwithstanding the impact of rising mortgage rates and the reduction in the federal government's first home owners grants. The charts to the left outline residential building approvals and private apartment approvals.

In summary, from late 2010 and continuing into 2011 it seems that the strong growth in housing prices post GFC has run its course, as reflected by falls in private dwelling approvals and slowing – and in some instances falls – in housing prices in the capital cities.

# The Building Energy Efficiency Disclosure Act 2010

The Building Energy Efficiency Disclosure Act 2010 (the BEED Act) commenced on 1 July 2010 with the disclosure obligations taking effect on 1 November 2010 and full disclosure obligations commencing from 1 November 2011.

The BEED Act impacts on:

- building owners selling or offering to lease office space with a net lettable area (NLA) of 2,000sqm or greater
- head lessors sub-letting office space with NLA of 2,000sqm or greater

## Disclosure

- During the 12 month transition period from 1 November 2010 to 31 October 2011, a National Australian Built Environment Rating System (NABERS) Energy star rating needs to be disclosed for a building owner to offer (or continue to offer) to sell affected buildings or for owners and head lessors to offer (or continue to offer) to let affected buildings
- After the transitional period, a full Building Energy Efficiency Certificate (BEEC) needs to be disclosed
- All advertisements must disclose the NABERS Energy star rating where an affected building is offered for sale or lease

## Limited Exemptions

### Automatic exemptions

- Newly constructed office buildings (and areas within such buildings) for which the certificate of occupancy is

- less than two years old
- Strata titled premises
- The sale of a building through the sale of shares, or units, or the sale of a partial interest in a building that would otherwise not be exempted
- Short-term leases and sub-leases of 12 months or less (including any option to extend)

### Application for exemptions

An exemption from the disclosure obligations may be sought in the following circumstances and would be granted on a case by case basis in circumstances where:

- an affected building or area is used for police or security operations
- an energy efficiency rating cannot be assigned because of the characteristics of the building.

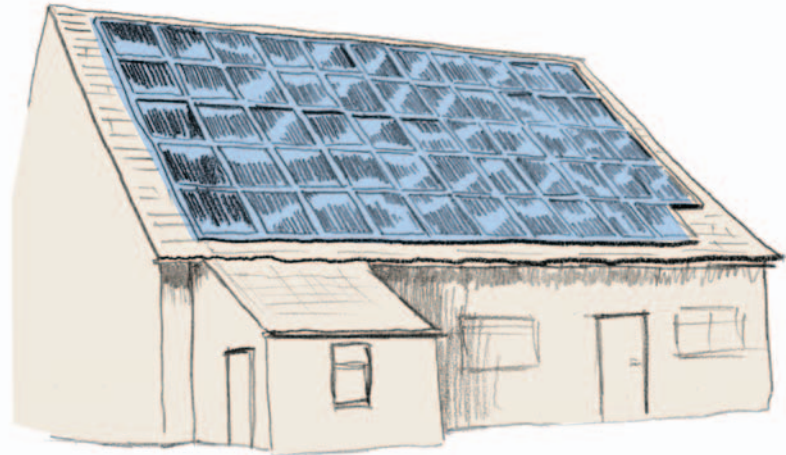
### Penalties for Non-compliance:

- Penalties exceeding \$110,000 may be imposed for non-compliance, accruing at \$11,000 daily

Anyone engaged in selling or letting a building subject to the BEED Act, including insolvency practitioners

appointed over buildings subject to the BEED Act, is now required during the transitional period to obtain a NABERS Energy star rating before they can commence marketing or offer to lease affected buildings where the lease term is greater than 12 months. There are limited exemptions where some are automatic and others need to be applied for and such applications are reviewed and decided on a case by case basis. Failure to comply with the BEED Act may attract significant financial penalties.

Additionally lenders may need to review their covenants to determine whether existing covenants adequately address the new mandatory disclosure requirements. If an affected building which is subject to a registered charge is in the process of being sold to satisfy an outstanding facility has a NABERS Energy star rating in place then the property can be marketed immediately if there are no other outstanding issues. Otherwise, there may be a considerable delay (two to three months) in obtaining a NABERS Energy star rating before the property can be marketed for sale or even leased, which may add significantly to a secured creditor's holding costs.



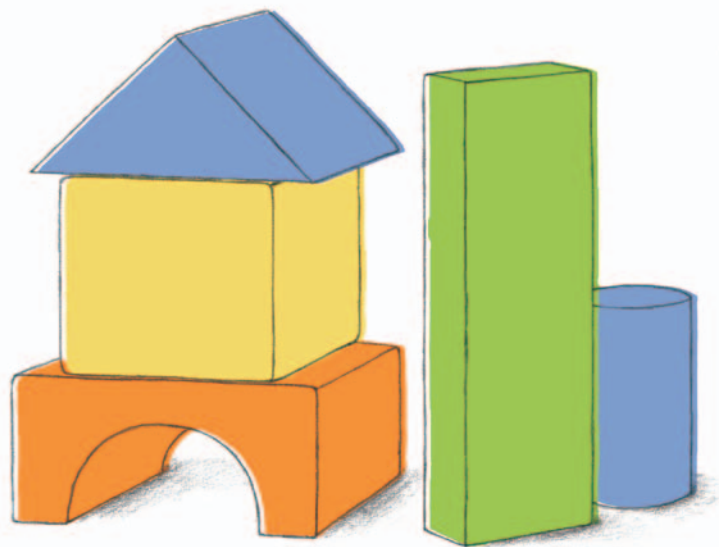
# Newsflash – Tax obligations of appointed insolvency practitioners

Some confusion has arisen, with regards to whether or not on the sale of an incapacitated entity's assets, a receiver is personally liable to remit tax to the Australian Taxation Office (ATO). Historical industry practice may have diverged from tax law and insolvency practitioners may become personally liable under certain circumstances for post-appointment tax liabilities including income tax, capital gains tax, PAYG and GST.

The receiver or mortgagee in possession (MIP) would be liable to remit GST to the ATO to the extent that GST is payable on realisation of a property. There is no conceivable method whereby the GST liability can be parked in the incapacitated entity as an unsecured pre-appointment tax liability - even if contracts were exchanged before the appointment of the receiver or MIP and settlement takes place after appointment. The receiver or MIP would be liable to account to the ATO for any GST arising from the realisation of the property.

A CGT obligation arises where a capital gain on realisation of property remains even after applying existing capital losses (if any). In such circumstances, a receiver is liable to remit the CGT liability to the ATO.

During a recent receivership appointment, legal advice was obtained that CGT arising from the realisation of properties may be averted by settling the properties as MIP, notwithstanding that contracts may have been exchanged by the receiver.



Where a MIP sells a property, Section 254 of the Income Tax Assessment Act 1936 (cth) appears to suggest that a MIP acts as an agent of the mortgagee and not the company/individual. The realised funds from the sale of the property under a MIP are the property of the mortgagee and not the mortgagor and therefore the MIP is not charged with the obligation to satisfy the mortgagor's tax obligation [Chant v DCT (1994)].

The Insolvency Practitioners Association of Australia (IPA) has recently held discussions with the ATO in an attempt to clarify the receivers liability for CGT on realisation of property. The ATO has not, at this point in time, clarified its position.

However, the position seems clear that if a secured creditor is realising assets subject to its security and suffers an overall loss in so doing, then no CGT liability arises if the assets subject to the charge are settled by a MIP.

Due to the complexity of the tax law surrounding the CGT issue, it is recommended that legal advice be sought on a case by case basis where property is being sold subject to a receivership, to:

1. ensure CGT liability is correctly dealt with in order to maximise the return to the secured creditor
2. avoid any personal liability to the insolvency practitioner in respect of CGT arising at a future point in time after the property has already settled.

# Case studies

In the past year, Grant Thornton has been involved in a number of complex property matters and transactions that required innovative solutions to achieve a positive result for the benefit of the secured creditor.

## Asbestos contamination

The secured lender appointed Receivers to the property assets of a distressed company. One of the properties had a history of extensive asbestos contamination and was well known to the local council. The potential for local council intervention and issuance of a notice under Section 91 of the Protection of the Environment Operations Act 1997 (NSW) (the PEO Act) was significant. To prevent the intervention of the local council and the issuance of notices which would have delayed the sale of the property, a pro-active program was undertaken to deal with the asbestos

contamination.

The program included the following and was completed in a number of weeks:

- Engagement of an accredited asbestos consultant
- Instructing the consultant to prepare an asbestos survey, asbestos register report and an asbestos maintenance and management plan
- Engagement of specialist asbestos removal contractors to decontaminate parts of the property
- Following removal of the asbestos, a clearance certificate was obtained from the contractors

By the time the local council sought to intervene and demanded a report from the Receivers on the asbestos maintenance and management plan for the site, the Receivers already had in place an acceptable asbestos maintenance and management plan and had mitigated the asbestos contamination. The local council was satisfied with the Receivers' actions. As a result, no intervention occurred and no remediation notices were issued.

The sale of the property was not unnecessarily delayed and a successful realisation of the site occurred. Potential buyers were not daunted by the asbestos contamination as the Receivers were able to provide potential purchasers with a report detailing an acceptable asbestos maintenance and management plan.

## Sale of a partially completed building

The secured lender appointed Receivers and Managers to the developer of an incomplete apartment complex. The complex required extensive remedial works to make the structure compliant with the Building Code of Australia (BCA).

Following an extensive review, the Receivers concluded that in order to maximise the realisable value of the building site it should be sold "as is" as the cost to complete the building would likely exceed its ultimate realisable value. Remedial works were undertaken to gain BCA certification, ensuring the building site was more attractive to potential developers to maximise the site's



realisable value.

The Receivers and Managers commissioned an Occupational Health & Safety (OH&S) report, which identified a number of issues requiring immediate action. The OH&S report was invaluable in identifying quick and relatively inexpensive fixes. This also pre-empted any intervention by the local council or WorkCover Authority.

Identified items included (but were not limited to):

- Capping exposed rio bars
- Placing mesh over void areas
- De-watering the site to avoid a potential drowning hazard for children who may wander on to the building site
- Lockable gates for the lift shaft
- Perimeter fencing to prevent unauthorised entry
- Site register to maintain a record of people accessing the site
- Certification of existing scaffolding on site

The pro-active remedial action undertaken resulted in numerous benefits, including:

1. Providing safe access for interested buyers to inspect the building site
2. Preventing council and WorkCover intervention by demonstrating a pro-active program of securing and making the building site safe

The actions undertaken by the Receivers resulted in the building site being sold for \$1.6m in excess of its market valuation.

### GST margin scheme

The secured lender appointed Receivers to a distressed property development company. The company had intended to develop residential premises for sale, however at the date of appointment the property was comprised of vacant land subdivided into lots.

The Receivers actively marketed the lots and a sale agreement was eventually entered into with another property developer for \$3.5m. The Receivers and the purchaser agreed that if possible, the land would be sold under the GST margin scheme.

The Receiver was required to know

the purchase price of the land as well as the history of the land ownership in order to apply the margin scheme correctly. It was established that the land was acquired from the previous owner as a GST-free going concern in 2009 for \$2.5m.

Under GST provisions introduced in December 2008, the Receivers were not able to simply calculate the margin on the difference between the acquisition costs and selling price (\$3.5m - \$2.5m), but needed to take into consideration the value added by the previous owner (the 'look through' approach).

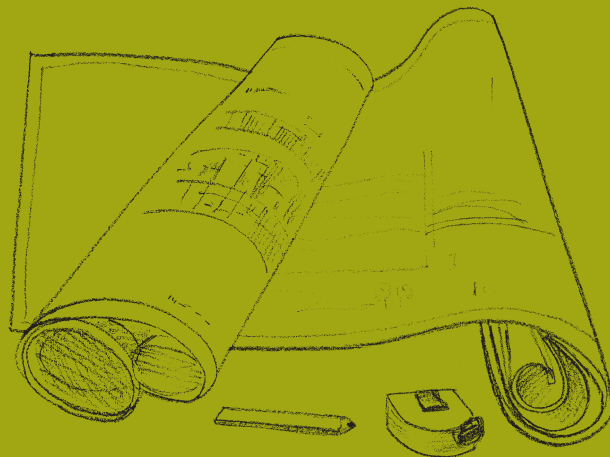
In addition, for the land to be eligible for the margin scheme, the purchase of the land by the previous owner must not have been subject to GST. This is because under the 2008 changes, if land has ever

been subject to a fully taxable supply, the margin scheme cannot be applied in respect of future supplies of that land.

The Receiver was therefore required to ascertain both the value and the GST status of the land at the time that the previous owner acquired it.

In this case the information was available and it was found that GST had been paid on the land acquisition by the previous owner. The margin scheme was therefore not available for this transaction and the sale of land by the Receiver was taxable in full.

It is important for Receivers and Lenders to be aware of the potential pitfalls in the operation of the margin scheme. This is a complex area of GST law and one that the ATO is focusing on in its current compliance program.



Grant Thornton is national full service accounting and business advisory practice that specialises in working with property and construction businesses of all makes and types, big and small. We closely work with our property and construction clients, so we understand this complex and diverse market well. If you would like to discuss any aspect of the above, please do not hesitate to contact one of our industry experts detailed below:

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# Industry Intelligence Unit

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The IIU is unique in its objective of providing stakeholders with information, understanding and analysis of the issues faced within specific industries and sub-industries. The IIU also seeks to provide pragmatic, commercial, practical measures and initiatives to improve stakeholder value.

## Industry focus

The IIU utilises the industry experience and expertise of Grant Thornton partners and staff across Australia. The IIU is predominantly focused on the following industries and their related sub industries:

- Property
- Retail
- Aged Care
- Automotive
- Hospitality
- Financial Services.

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