



Options for meeting financial obligations **in challenging times**

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A quick tour of the **next 60 minutes**

- What are these options?
- Attributes of these methods
- Tax
- Why borrow?
- Questions
- Renewal
- Summary





Fasten your seatbelt –
it will get **hectic**

- Money is **emotional**
- The **maths** can get **complex** and **counterintuitive**
- And then there is **tax**
- I'll cover a lot of topics – this is a super-fast overview, not a uni lecture
- NOT a tax adviser, this is NOT tax advice
- Differences between each state



What's **my goal** today?

- Economics of owner corporations is **broader** than most people think
- The **concepts of finance theory** can guide us
- You can't forget **tax**
- People to **think more deeply** about their options – more reasoning, less emotion

Sources of Funds for an OC

- Traditionally, three sources:
 - Sinking/Maintenance Fund
 - Special Levy
 - Borrowing

Sometimes a fourth avenue...
other people's money:

- Insurance
- Negotiation
- Litigation
- Government



Attributes of funding sources

	Pros	Cons
Sinking Fund	<ul style="list-style-type: none"> • “There when you need it” 	<ul style="list-style-type: none"> • “It’s not there when you need it” • Expensive
Special Levy	<ul style="list-style-type: none"> • Efficient 	<ul style="list-style-type: none"> • Onerous cash flow impost
Borrowing	<ul style="list-style-type: none"> • Cheapest for most owners • No waiting 	<ul style="list-style-type: none"> • Lack of understanding by owners • Australian love/hate relationship with debt
Insurance	<ul style="list-style-type: none"> • No (or limited) impact on current cash flows 	<ul style="list-style-type: none"> • Limited to “insurable events” • Ongoing premiums
OPM	<ul style="list-style-type: none"> • Seemingly no cost 	<ul style="list-style-type: none"> • Significant shoe-leather
Litigation	<ul style="list-style-type: none"> • No cost if you win 	<ul style="list-style-type: none"> • Legal costs if you don’t win (yours and theirs) • Difficulty of tying down the appropriate counterparty • Insufficient when based on estimates, not actuals • Time

Fallacy of a Sinking/Maintenance Fund as an **“equitable distribution of costs over time”**

Why **borrow**?



Cheaper for majority of owners



Cheapest 'weighted average cost of funds'



Immediate



No 'dormant funds' accumulating over time in a sinking fund



No severe cashflow imposts

A quick overview...

Tax in Strata

- Four relevant taxes
 - **Income tax** for the owner
 - **Income tax** for the corporation
 - **Capital Gains Tax**
 - **GST**



A quick overview...

Tax in Strata

- Four types of owners
 - Residential owner occupier
 - Personal investor
 - Company investor
 - Super fund investor



A quick overview...

Tax in Strata

- How many types of levies?
 - Sinking Fund Levies
 - Special Levies
 - Administration Fund Levies
- 1 – Levies to the sinking fund
- 2 – Levies to the administration fund



A quick overview...

Tax in Strata

- Each of the two types of **levies** play out **completely differently** for each of the **four taxes** for each of the **four types of owners**



A quick overview...

Tax in Strata

- Q: Who knows this?
- A: Far too few people
- Unfortunately, you can't just go to your adviser because they probably have never thought about this



Concepts from **Finance Theory**

- Opportunity Cost – the next best thing you could do with your money
- ROI – Return on Investment
- Capital Budgeting



Opportunity Cost

- “No free lunch”
- The money you pay in levies is not free
 - Do you have credit card debt?
 - Would you have credit card debt?
 - What about that new car?
 - Or giving it to the kids?
- Whatever is the next best thing that you could do with your cash is your **Opportunity Cost**



Return on Investment

- What's the **bang** for your buck?
- What **value** do we get in return?
- Financial return + how do you feel?
- Owner occupiers **vs** investors



Applying finance theory to **strata**

- Get out of the scarcity trap – think **ABUNDANCE**
- **Think** investing, not expensing
 - Invest means **ROI**
 - Expense means **cheap**
- Not the cheapest **quote**
- Not the cheapest **project**



What's bad about **Sinking Funds?**

- People don't think
- Not account for **opportunity cost** – is the money better in your pocket or the OC's pocket?
- Financially inefficient – typically the most expensive form of funding
- Low returns
- Not free money



Special Levies are **not** the **devil**

- Cost effective
- Cause for people to **think**
- Concerns
 - Cash flow **impost**
 - Opportunity cost
 - Like a Sinking Fund, is **not free money**
 - What if some people can't pay? – impacts timing



More about **Strata Loans**

- Gets you out of scarcity mode
- Spreads cash flows over time
- Cheaper, **after tax**, for the **majority** of owners!
- Quick
- **Off** balance sheet – doesn't affect your available funds or lines of credit
- Not free money



If strata loans are **so good**, **why don't people use them more?**

- Lack of **financial understanding** – owners, managers and legislators
- Strata **naysayers** subvert the decision processes – natural desire for **consensus**
- Australians **say** they don't like debt
- The **FUD** factor
- Inappropriate **legislation**



Questions – Will **Why aren't strata loans cheaper?**

- Unsecured
- Bank capital weighting
 - BASLE III, APRA
 - The higher the capital weighting, the more expensive
- Size of market and economies of scale – the mortgage market in Australia is **20,000** times bigger than the strata loan market



Questions – Susan

Hybrid loans

- Trying to solve this for a long time
- Two broad types of “solutions”
 - Special Levies
 - Some owners lend to the corporation
- Evaluation **metrics**
 - Complexity
 - Fairness
 - Compliance
 - Understanding
 - Hidden consequences



Questions – Susan

Hybrid loans – Special Levies

- Raise a special levy
 - Apply the discount on early payment and or the interest rate on arrears
 - People who can or want to pay do
 - Corporation borrows the amount unpaid
- Consequences
 - Disenfranchises the non-payers
 - Unknowable time frame for non-payers
 - Very difficult to get the maths right



Questions

Hybrid loans – Owner Lending

- Cannot offset (i.e., “net”) the interest earned by the lending owner against the levies they must pay
- Interest earned by the “lending owners” is taxable at their marginal rate
- Administrative burden



Questions

Hybrid loans – issues for managers and OCs

- If you are a strata manager – can you (and your auditor) reconcile “netting” with their obligations under the Property , Stock and Stations Act?
 - NSW OFT – must go through the bank accounts, not internal ledgers
- What is the administrative burden and what will that cost?



Questions

Hybrid loans – if you are an owner

- What is your real cost of funds?
- What is it after tax?
- What is it in comparison with the after tax cost to you of a strata loan?
- At what rate will the interest you receive on your loan be taxed?



Questions – Susan

Selling my unit

- If there's a strata loan, a purchaser won't pay as much because the levies are higher

Strata Loan		Special Levy	
Owner perception of value	\$100	Sale Price	\$100
Notional share of strata loan	\$10	Required investment to get that value	\$10
Sale Price	\$90	Net return to seller	\$90

Questions

Selling my unit – what's really going on?

- We should **think broadly** – we like to fool ourselves about values
- Think in terms of return, i.e., **ROI**
- In strata, owners always pay, all the time – **compare** – there's always another side to the funding coin
 - Cost of finance
 - Opportunity cost
 - Capital value
- It's right to focus on the cost of funding, but shhhhh, there's a secret.....



Questions

A little strata secret

- Of course I want people to **think deeply** about the economics of strata funding, but.....
- The costs of each funding alternative are **not too disparate**
- Where is the **big** impact on ROI?
 - The **project** you choose
 - The **contractor** you choose



Questions – David and Malcolm

Water Leakage and Deck

- 51% majority required in NSW
- If no satisfaction from the OC, consider NCAT
- Considerations for the 49% against a loan:
 - What is your cost of funds (opportunity cost)
 - What is it **AFTER TAX**?
 - Impact on rental return
 - Impact on capital value



Questions – David

Another little strata secret

- **NEVER** stage a project
- Why do we try to stage projects?
 - Scarcity thinking – we don't have the cash
- Why we should **never** stage projects
 - Inflation – CPI, LMI
 - Duplicate costs
 - Duplicate effort
 - Inconvenience of living in a construction zone
 - You just get **TIRED**



Strata **Renewal**

- "We have **[insert problem here]** but if we do **[insert good idea here]** and put a penthouse on the top then we fix all the problems, add new features and selling the penthouse will pay for everything"

Strata **Renewal**

- Glenview Towers – before
 - Two **fire** orders
 - Concrete **cancer**
 - 78 lots with 180 degree ocean views and **no balconies**
 - Only 50 car spots, all open air
 - An **ugly** blot on the landscape
- **Skye** Tamarama – now
 - **2 lifts** instead of one
 - **78 balconies** with floor to ceiling glass doors
 - Underground parking for **90 cars** with lift access
 - 2 penthouses now **on the market**
 - A **pleasing** blot on the landscape

Strata **Renewal**



Strata **Renewal**



Summary

- Broader and deeper thinking
- All three options have merit
- Opportunity Cost
- ROI
- Get rid of scarcity thinking and costs
- Think in terms of investment and returns
- **TAX!** Educate your trusted adviser



The real takeaway

- **Abandon** your scarcity mindset
- Think about **returns**
- Let loose your **imagination**

