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YSP Podcast Transcript: Episode 332. What is a hybrid strata loan? - Andrew Boss, Austrata

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Intro: Welcome to Your Strata Property, the podcast for property owners looking for reliable, accurate, and bite-sized information from an experienced and authoritative source.

Amanda Farmer: Hello and welcome to this week's podcast episode. I'm your host, Amanda Farmer, and my guest this week is Andrew Boss. Andrew is a seniour financial services executive with over 25 years in banking and finance, private equity, commerce and consulting organisations. Andrew specialises in developing and transforming businesses, and his experience includes 6 years with Westpac Bank, 5 years in private equity funds management, being CFO of 2 ASX-listed entities, and investing in numerous business startups. Andrew is currently CEO at Austrata Finance. A proud Data#3 and a sports tragic, Andrew's words. In his limited spare time, Andrew enjoys working on his golf handicap across the fairways of Sydney. In this chat, Andrew shares how Austrata has eliminated a longstanding problem in the strata loan market. I'll take you straight on over to my chat with Andrew Boss.

Andrew Boss, welcome to the show.

Andrew Boss: Thanks for having me.

Amanda Farmer: Andrew, tell us about the background to Austrata Finance. How did this all come about?

Andrew Boss: A previous employer of mine had a flammable cladding remediation project management remediation business, and they tasked me with setting up flammable cladding fund basically to compliment that business. As it turns out, the owners of my previous employer, they had an acrimonious partnership split, so I ended up pursuing the flammable cladding fund without them in conjunction with our current chairman, Gary Tescher. And that has morphed into the business that you see today, Austrata Finance. Obviously, we provide funding for flammable cladding, but for a myriad of other purposes.

Amanda Farmer: Okay. And today we are not talking about cladding funding. Necessarily, I suppose in a way, funding for the removal of flammable cladding still plays a role, but more generally we're talking about strata loans. So at some point, you and your team have come up with a creative solution to what I see as a common problem with strata loans. We're going to talk about that. First of all though, for our listeners who may not have come across the concept of strata loans or been involved in one before, can you let us know what they are and why a building might want to consider a strata loan?

Andrew Boss: Quite simply, the owners of a strata scheme might consider taking out a strata loan if they don't have enough money in their sinking fund to pay for a major project. That's been the case in the majority of the customers that we've spoken to and provided loans to. They simply just don't have enough of their own money to pay for the works that need to be done. And to your point about flammable cladding, that's absolutely right. I mean, we thought that would be the dominant purpose in terms of why people need money. The biggest issue is actually water penetration. And that can mean any number of things, whether it's a rooftop terrace that hasn't been properly waterproofed or the replacement of balconies or balustrades, concrete cancer, the waterproofing of bathrooms, you name it. Water is the biggest issue for strata buildings here in Australia in our experience. Flammable cladding obviously is there, but there's a number of other reasons.

We've provided loans for the replacement of equipment that's come to the end of its natural life. Lifts will last 20 years, there thereabouts, and they cost upwards of half a million dollars. And oftentimes a strata scheme won't have enough money in their sinking fund to pay for that, and the owners just don't have the wherewithal to raise that sort of money.

So in terms of what is a strata loan? It is a loan to your strata scheme. It's a legal entity in its own right. So it is a loan to your strata scheme. Call it an owners corporation in New South Wales or Victoria, ACT, or a body corporate in Queensland. It's a loan to that legal entity. It's not a loan to the underlying apartment owners or to the lot owners. So it's an important distinction. There's a relationship between a lender such as ourselves and the borrower, the owners corporation. That's the first relationship. The next relationship is that between the owners corporation or the body corporate and each of the apartment owners. The simple mechanics are that the apartment owners pay levies to your body corporate or to your owners corporation. And it's the collection of those levies that then allow the loan repayment to be made to the external funder.

Amanda Farmer: And therein lies one of the challenges inherent in the strata loan structure. Do you want to dive into that, Andrew?

Andrew Boss: Yes, I might talk more generally about some of, let's just say the challenges with strata lending in itself.

Amanda Farmer: Go for it.

Andrew Boss: In our view, there's been 3 main issues with strata lending being accepted from a mainstream perspective. And the 3 issues are these.

The first is price. Strata lending rates have been too high, pure and simple as that. Historically, the gap between home loan lending rates and strata lending rates has been 4%, 4, 5, 6, 7, in some cases as much as 10% higher than home loan rates. It just turns customers off. And unfortunately, it's created a reputation for strata lending being the option of last resort. So that's the first issue. The second issue is the lack of product flexibility. And that stems from some pretty rigid strata legislation. Until we entered the market with our product that we'll talk about in a second, a strata scheme, if they needed to raise additional funds for a project, it really only had 2 choices. Either raise a special levy whereby everyone stumps up the cash upfront, so everyone dips into their own pocket; or the strata scheme borrows from an external lender. It's a case of either or. So everyone pays up front or everyone participates in the loan and everyone pays interest or pays their share of the strata loan interest.

And the last issue, and probably less aside, but in many cases, just as important is customer service. We've heard many instances of strata schemes having to wait up to 6 weeks for loan applications to be turned around by another lender in the market because that lender's strata deals go into the same bucket as all the commercial deals that they're assessing and they receive no priority. So those are what we believe to be the 3 main reasons that strata lending has not been as prevalent as what it otherwise could or should be.

Amanda Farmer: How is Austrata addressing those challenges?

Andrew Boss: Yes, it's a good question. Let me say from the outset when we were first contemplating entering this industry as a strata lender, I was fortunate enough to be introduced to the principles of some of the biggest strata management firms here in the country. And they were the ones that sowed the seed in terms of what the holy grail, so to speak was. And that was to provide a product that can be a middle ground and a middle ground such that if a strata scheme needs money, if the owners of that strata scheme need to raise money to pay for a significant project, that if we could build a product that allowed some owners to pay up front and then pay no more. And in doing so, avoid paying their share of interest on a strata loan. So having that cohort of owners and then allowing the other owners who don't have the financial wherewithal to pay front, allowing them to spread their financial commitments over the life of the loan. Their advice was if you create that product, you will break open the market. And that's what we've done. We've termed it our hybrid loan.

Amanda Farmer: I'm going to ask you how this hybrid loan works, but I first want to acknowledge that I am asked all the time by owners, and we've discussed it here on the podcast, about the option to have the type of loan where, as you say, some owners who can afford to pay upfront and avoid the interest can do so. It's a topic of discussion that's come up in my own community when we were looking at having to borrow a significant amount of money. I am not surprised that the leaders of these big companies were having those discussions with you. And I agree that this is a game changer. I also am aware that we have some restrictions in our legislation about how we can recover contributions from owners. And indeed that has been a stumbling block for more flexible lending arrangements. So I'm excited to hear. How does the Austrata hybrid loan work?

Andrew Boss: Yes. The precursor to that is what is the restriction in strata legislation? And that restriction is that all owners or all lot owners must be charged levies uniformly, basically, and in accordance with how much of the strata scheme they own. So what does that mean? It means that some owners can't pay an upfront levy and other owners pay a levy over the life of the loan. You just can't have it. If you could, the existing strata lenders would've rolled out a product like this 15, 20 years ago. It would've been around forever. But unfortunately, strata legislation prohibits that.

So how does the hybrid loan work? For those owners who want to pay upfront, they do so not via paying a levy, but they do so via making a loan to the strata scheme. So actually, they are paying upfront via a loan to the strata scheme.
The next point is that all owners are charged loan repayment levies, including those who pay upfront. So all owners are charged a loan repayment levy in accordance with how much of the strata scheme that they own.

The third point is for those owners that pay upfront, and this is really the secret source of the product. Those owners who pay upfront, the loan repayment levies that they are charged is offset by the loan repayments that they receive from the strata scheme. Let me repeat that. The loan repayment levies that they are charged is perfectly offset by the loan repayments that they receive from the strata scheme. So they have no more to pay. So on their levies invoice, they will see their admin levies, their sinking fund levies or capital works levies, call it what you will. And then they'll see a loan repayment levy that will appear on their invoice because they have to be charged that to conform with strata legislation. But they will then see credit, a loan repayment credit on their invoice such that the net amount payable is just their admin and sinking fund levy amounts. That's how it works.

Amanda Farmer: Now you have a very informative, I thought, short video on your website, which I will make sure we link to in the notes. That was the first thing that I watched when I heard about this product and I wanted to understand how it worked. Listeners, definitely go over and watch this video, but I'll try my best to articulate the very good example that's given in that video. Which is that if Jane was living in a building where a million dollars worth of work needed to happen and her building had 10 lot owners, everybody had equal unit entitlement, then if owners were paying out of their own pocket, they'd each have to contribute $100,000 to this million dollar project. And this is a community where Jane can afford to pay her 100,000 upfront. She's got the money in the bank, but the 9 other owners cannot and they want to get a strata loan.

So Jane and her community have come to Austrata. You've said to them, "We can absolutely do that, and this is how we do it." Jane lends her $100,000 to the owners corporation. The owners corporation takes out a million dollar loan with Austrata, and the owners corporation pays back the money that it owes to Jane under her loan. And let's say that it needs to pay her, I think the example on your website is something like $7,000 a month, it needs to pay Jane as the loan repayment for her loan. And at the same time, every owner, including Jane, needs to pay $7,000 a month to repay its loan to Austrata. So 9 owners are making their loan repayments, and Jane is also making her loan repayment, but she's receiving a loan repayment in return from the owners corporation. So what goes in for Jane automatically goes back out. So she's in no worse off position. What have I missed there?

Andrew Boss: Pretty close to the mark. Pretty close to the mark. Just a couple points. Each owners, they're not making a loan repayment themself, they're paying levies.

So each owners pay the loan repayment levies. So it's an important distinction, and we spoke-

Amanda Farmer: Oh yes. Good one.

Andrew Boss: ... about the different relationships. That's the first point.

The other one there was the strata scheme needs a million dollars to pay its builders and contractors. So Jane lends 100,000. Austrata only lends 900,000. So it lends the residual amount such that the strata scheme has provided literally cash in the bank of a million dollars. And in that respect, it doesn't matter whether it's Jane is only one of the owners who pays upfront 100,000 and Austrata puts in 900,000, or it could be 2 owners or 3 owners or 5 owners. It doesn't make any difference to your strata scheme because of the way that we've designed the product.

Amanda Farmer: Now, a few questions arising from that. Jane's loan to the owners corporation is unsecured?

Andrew Boss: Yes, that's right. Just as Austrata's loan is unsecured. In Austrata's case, the security comes from the levies that are paid. So Jane's loan is absolutely unsecured, and it's in that respect is no different to a special levy. In fact, her position is more secure than if she had paid a special levy because that's effectively money that's gone, so to speak. The money that she has paid, if you had an Armageddon situation where the building was condemned and the block of land was being sold off, she would be a creditor and she would be entitled to receive a distribution of the amount that's owed her. And just the same as Austrata. And in fact, part of the design of the product is that Jane ranks equally with Austrata. So she's not disadvantaged, she doesn't sit behind us in terms of priority. She ranks equally. And we've deliberately designed it that way in order to pass the pub test as much as anything.

And do you, Jane and any other owners who want to pay up front with a written loan agreement, do you do all of that or Jane goes off and sorts that out herself?

Andrew Boss: No, no. We prepare all of the loan documentation and we've got a bevy of lawyers that we use. And we've utilised Colin Grace, Grace Lawyers and Madison Marcus more recently from Austrata law perspective. But we use Dentons who are prominent banking and finance legal firm here in Australia and indeed globally. They've prepared all of our loan documents. So the Austrata loan itself is a regulated loan. Loans to strata schemes are deemed consumer loans. So they're regulated by the NCCP Act. The loans from the lot owners to the strata schemes are not regulated. And in fact, it's one of the conditions, one of the warranties that we have the owners actually make. Is that they're not in the business of providing loans.
So we've created, or Dentons more specifically has crafted the loan document between the lot owners and the strata scheme. And many of the provisions are similar with the Austrata loan agreement and in fact, such as the design of the product that the loans work in concert with each other. So if the interest rate on the Austrata loan changes, well the interest rate on the lot owner loan changes as well. They work in perfect symphony with each other.

Amanda Farmer: Look, it's very clever. I'm sure we're delving into territory where listeners are going, "Amanda, we don't really care about all that technicality."

Andrew Boss: Yes, that's right.

Amanda Farmer: "Stop being lawyerly. We just love the fact that this is available to us." So I get it. But a question that I think is very relevant to owners who are thinking about this is what happens if you want to sell? If you've lent that $100,000, the project's not complete, the loan is still outstanding, and Jane decides, "I'm moving on. I've had a kid and I want to go and live in a 3-bedroom rather than 2-bedroom." What happens?

Andrew Boss: Yes, it's a really interesting point. When we originally designed the product and launched it to market earlier this year, the solution in that scenario is that Jane would be paid out the balance of her loan at the time of sale. But the overwhelming feedback from our customers was they don't want that to happen. They want the ability to sell the apartment such that the incoming purchaser has no more to pay. So we've changed the product. So what does that mean? If Jane sells, when she sells, all of the disclosure documents will show, yes, these are the levies that are payable, but this agreement is in place and the incoming purchaser does not have to pay these loan repayment levies. And we changed the product on the back of that customer feedback.

Amanda Farmer: Just on that. I find that so interesting because I would've thought it'd be the other way around. If you think about a normal strata loan arrangement, sometimes owners want to sell for exactly that reason. They want to get out of the ongoing obligation to be paying off this loan, and their purchaser then buys in, has the responsibility of course for paying levies, which include the loan repayments and continues on and also gets the benefit of the completed projects. That kind of makes sense. I find it really unusual that an owner would be happy to stamp up this cost and then sell out, not get the benefit of the completed project and not get any money back.

Andrew Boss: We thought it was unusual as well, but we've listened to the customer and we've made the change. I want to talk about another product, I would call it enhancement that we've made in recent times as well. And again, this is based purely on customer feedback. We've introduced the option for an owner who pays upfront if they encounter financial distress. If they lose their job, for instance, they can apply to the strata scheme to have the balance of their loan repaid. And how that's done is via Austrata providing a top up. So Austrata will increase their loan and the owners corporation will use the proceeds to pay out that lot owner's loan. So again, based on numerous requests from customers and feedback and requests from customers to have that product feature available, so we have.

Amanda Farmer: That's a good idea. There has been some criticism of your product from market competitors. I think I can say that because it's been in the media. How do you respond to that?

Andrew Boss: Yes, it's an interesting one. I guess if I was one of those competitors and you saw a new player come into the industry offering a product that's been described by some as the holy grail of strata lending, you'd be inclined to try and discredit the product as well. So if I run through what those objections have been, the first objection is that our hybrid loan doesn't comply with strata law. Now, I'll make the point here that we had no fewer than 3 different types of lawyers participate very heavily in the development of this product. And it took us 12 months to bring the product to market. We had a banking and finance lawyer, Dentons; we had a strata lawyer, Colin Grace; and we had a compliance lawyer, Loyal, along that journey every step of the way. Which culminated in respective sign offs from each of them, but most specifically from Colin saying that the product conforms with strata legislation. So we have that in writing. Colin's actually on a sabbatical now. So we actually sort a second opinion from Madison Marcus, and we have it in writing from Madison Marcus that the hybrid loan complies with strata legislation.

Amanda Farmer: And just on that point, you are nationwide, so this is ticked off in each state or?

Andrew Boss: No, not yet.

Amanda Farmer: Not yet. Okay.

Andrew Boss: Not yet, Amanda. We've confined our activity at this point to each of Queensland, New South Wales and Victoria. In the ACT, there's a little bit of flexibility in their strata legislation that may not make the hybrid loan as attractive as it is in the other 3 eastern seaboard states. We will definitely with time launch into South Australia and Western Australia, but just not yet.

The next objection is that the hybrid doesn't comply with the trust provisions of the Property and Stock Agents Act in New South Wales. And there's been hearsay in the market about the Office of Fair Trading, et cetera, et cetera. The facts are the Office of Fair Trading haven't actually seen our documents. So they've not provided comment based on real facts. So if we ignore that hearsay when we stick to solid legal principles, we've been provided 5 pages of advice from Madison Marcus, which in summary says a hybrid loan doesn't contravene and in fact, it complies with the PSAA. So that's fine.

What else? We also heard some noise from an accountant who I gather gets referred business from one of our competitors that GST is not dealt with properly. It does. We provide each of our strata management firms with a comprehensive hybrid loan briefing paper, that details, the general ledger treatment of our hybrid loan, including GST. So there's no issue there.

And lastly, we've heard rumblings that the hybrid loan creates a whole load of extra work for strata managers. Part of our hybrid loan offering is that we manage all aspects of the hybrid loan for the entire term at no ongoing cost. And in the process, we limit the workload of the strata manager and equally their back office team. And I've met with back office teams of some of the largest strata management firms and worked hand in hand with them in terms of how can we make this process as streamlined as possible. And that's critical for us to continually refine our processes and procedures because we need to make life easy for them. If there's nothing else we've learned in 18 months in the industry, it's that strata managers are extremely time poor. So we need to make life easy for them or else they'll just blacklist our product and us as a business.

Amanda Farmer: Very true. So you're out in the market, you've got owners either directly or via their strata managers coming to you and signing up for these hybrid loans, they're ready to go?

Andrew Boss: Yes, absolutely. We've got half a dozen that have approved the loan and we're in various stages of draw down right now. I think the smallest of those is 1,000,000, 990 I think it is. And the largest is 5 million. So it's proving extremely popular and for obvious reason. And I just think...

Actually, there's one thing that I missed commenting on before, and I just want to sneak it in here at the end if I could. And that's the point on price. 3 months ago, an organisation called Columbus Capital invested in our business and we're effectively now a division of Columbus Capital. Now, they don't have a household brand per se, but they're Australia's third biggest non-bank lender, they have more than $12 billion worth of home loans on their books right now. What Columbus provides to us, in addition to a whole bunch of operating capability, is they provide access to multiple wholesale funding loans. And we're really confident that with time we'll be able to obtain cheaper finance from the market, which will lead to lower customer rates. We're really confident that that's going to happen. And that addresses product flexibility I think we've dealt with as one issue, cheaper rates. We're in the process of dealing with that, and we've got some pretty competitive rates in the market right now. And the last is customer service and you know how I call it we're a digital end-to-end business, which customers like. We make life easy for them.

Amanda Farmer: And on the point about flexibility and the strata legislation and making sure that everything is done correctly. I think it is incumbent on me as the host of this podcast and as a lawyer to make sure I do say to listeners, if you're looking into this kind of option, absolutely seek your own legal advice. It sounds like Austrata is armed with theirs and is no doubt able to share the details of that with you. But in order to give comfort to your owners, especially your lender owners, and I think if I was a lender owner, I'd be getting my own advice as well to make sure that everyone can move forward with confidence. Then it's important to tick off that box of obtaining your own advice and making your own informed decision.

Andrew Boss: Yes, I couldn't agree more. And we actually make that point in our literature that we send out to owners and we hold numerous information sessions and we have comprehensive Q&A. And we actually encourage strata schemes to bring along their lawyers or their advisors. And in fact, we've had several occasions where they've done just that. And interestingly, we're now getting referrals from some of those lawyers. So they've reviewed our documentation, they've participated in our presentations, they've seen our literature, and they're comfortable with it.

Amanda Farmer: Well, where do our listeners go if they want to get started with a hybrid strata loan?

Andrew Boss: There's a few ways they can get in contact with us. Our phone number is 1300 936 560, or they can go to our website, **austratafinance.com.au**, or just email us direct info@austratafinance.com.au.

Amanda Farmer: Excellent. I'm sure you'll have some listeners reaching out, Andrew. Thank you so much for spending time with me today to explain the Austrata hybrid loan product, and I'd be pleased to hear in say 12 months' time or so how it's all rolling out. No doubt I'll hear through the grapevine as well how things are going, and look forward to catching up in person sometime soon.

Andrew Boss: Thanks, Amanda, for having me.

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