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**YSP Podcast Transcript: 396. Hybrid strata loans have become even more flexible**

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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, strata lawyer, Amanda Farmer, and I'm here each week helping you to demystify the legal complexities of apartment living.

My guest this week is Andrew Boss. Andrew is a senior financial services executive with over 25 years experience in banking and finance, private equity, commerce and consulting organizations. Andrew's experience includes six years with Westpac Bank. Five years in private equity funds management, being CFO of two ASX-listed entities and investing in numerous business startups. Andrew is currently CEO at Austrata Finance.

This is the second time I've had a chat with Andrew on the show. Our earlier chat is in episode 332 when Andrew introduced us to the concept of the hybrid strata loan,
something owners had been looking for for a long time. The Holy Grail, in fact, we refer to it as, if you haven't listened to episode 332, and you wanna find out more about hybrid loans, head over and have a listen to that one.

Today's chat is about how the Austrata hybrid loan has evolved, allowing owners to opt out and self-fund when the time is right for them. Plus, Austrata has now been able to cover off some of those pesky taxation questions.

To fill you in on all the details, I'll take you right on over now to my chat with Andrew Boss.

Andrew Boss, welcome to the show.

**Andrew Boss:** Thanks for having me Amanda. Great to be here.

**Amanda Farmer:** Indeed, we're having you back. You have been a previous guest on the show, episode number 332. You were first introducing us, Andrew, to hybrid loans. Now I want to be conscious that some of our listeners may not yet have caught that episode. So let's just cover off again for anyone who's not yet familiar. What is a hybrid strata loan and why might our strata owners want one?

**Andrew Boss:** Why do they want a strata loan? Well, fundamentally it gives them a choice. It gives individual apartment owners the choice of using borrowed money or their own money when paying for their share of a project on their strata building. That's why the hybrid loan is popular and that's why strata owners want it, because it gives them that choice.

**Amanda Farmer:** When we spoke back in episode 332, you were saying Andrew that this concept of a hybrid loan where an owner can either be part of a strata loan or not, they can pay their share upfront and not be part of the loan. You said this was kind of the holy grail of strata loans. It's something that owners have wanted for a long time. They want this flexibility. They want this option, but the loan providers in the market until Austrata hasn't been able to provide that option. Can you speak a little bit to, since we last spoke, how this is now landing with managers and with owners, this concept?

**Andrew Boss:** Sure, there's a lot to unpack in that question there. Firstly, the Holy Grail. Yes, I may have used that term, but I was only relaying what had been conveyed to me. And it's probably worth calling out. The problem as it is in terms of the one-in, all-in approach with strata was first conveyed to us by Chris Duggan and his team three years ago now and a few other owners of strata management firms as well.

And they told us about this structural issue that the industry has, where when there's a project to be funded in a Strata Scheme and there's not enough money in the sinking fund, then the choice is either a strata loan to the body corporate or the owners corporation, call it what you will, either a loan to the body corporate and everyone effectively participates in that, so everyone pays strata loan interest, or alternatively, as a special levy that's raised. And that requires everyone to put their hand in their pocket and pay immediately, effectively.

So there really wasn't that middle ground, because typically, and we've certainly experienced this over the last couple of years, oftentimes there are two cohorts of owners those with the financial capacity to pay their share and then others who don't, they simply don't and that's becoming even more prevalent with the cost of living pressures that exist right now. So this hybrid loan product that we've developed, it does provide that solution. So it caters for both cohorts of owners.

Now there are many elements to that question. Let me talk about how it works. The product has evolved over the last couple of years and it's based on our experience, both in terms of what the owners want, but more so practically, we've learned a huge amount via the numerous projects that we've funded over the last couple of years with a hybrid loan.

What the product now is that the project itself is funded by a loan from us, a loan from Austrata Finance. So the project is funded progressively drawn, with interest only paid on the balance of the loan as it's drawn. Then when the project is finished and the actual cost is known, so it's not an estimate anymore, there are not unknown variations here to be incurred and the like, but once the actual cost is known and therefore once every apartment owner knows what their share of the cost is, all owners are invited to refinance their share of the loan.

So let me say that again. All owners have the opportunity to effectively pay off their share of the loan. Now, how do they do that? They do it via replacing part of the Austrata loan with a loan from themselves to the body corporate. So there are a couple of key points here. The total loan amount doesn't change. So the total loan amount doesn't change levies required to repay that total loan amount don't change as well.

Effectively, what happens is for those owners who refinance their share of the loan, and we call them a self-funding owner, that is the terminology that we use, intuitively that seems to make sense. So the loan from the self-funding owner is interest-bearing. In fact, it has the same terms and conditions as the loan from Austrata.

So you've got a total loan amount at an interest rate of whatever it is, with a loan term of five years, seven years, three years, 10 years, whatever it may be. The composition of the loan doesn't matter in terms of how many self-funding owners there are as distinct from non-self-funding owners, where their funding comes from Austrata Finance effectively.

The key point here, and really the secret source, if you like, of the product is that for those self-funding owners, once they make that lump sum payment, once they refinance their share of the loan, they have no more to pay. So they get charged levies, they get charged loan levies, but they receive a loan repayment credit from the body corporate, such that on their invoice, they'll see admin levies, they'll see sinking fund levies if we use Queensland terminology.

So there'll be admin levies sinking fund levies, there'll be loan levies, but then there'll be a loan repayment credit in the exact offsetting amount for the loan levies. So once they make that lump sum payment, there's no more to pay. And that's the objective of the hybrid loan, using your own money and avoiding the strata loan interest.

**Amanda Farmer:** Can I just stop you there? So you've mentioned the initial loan facility. This sounds a little bit different to what we were talking about this time last year. Are you saying there is going to be a period of time where every owner has to be part of that initial loan facility and responsible for repayments under it? Or what's your position as the lender during that period?

**Andrew Boss:** So, that's right. Our initial hybrid loan product, if you like, was a pay up front. So those owners who had the money could pay before the project started. And what experience has shown is that creates all sorts of administrative hassles for the strata manager and for us and for the owner themselves.

And let me cite a few examples. Let's say you have an owner who makes that first payment, with the first drawdown, they make the second payment at the next drawdown, but then for whatever reason, they're unable to make the third payment or the fourth payment. And so they've been receiving loan repayment credits and being charged levies, but then all of a sudden they convert from being a self-funding owner to a not self-funding owner. It creates all sorts of hassles for the strata manager. That's one example.

Another example, what happens if during that project period, you have a self-funding owner who's paid some of the lump sum amount, and then they sell their apartment. So who's liable to make the rest of that lump sum payment? Is it the incoming purchaser, or is it the outgoing vendor?

Now, there are solutions to all of these issues, but it's time and effort, not so much from us, but it's the strata manager because they just want life to be easy. And we've had an experience where this became a protracted negotiation between an outgoing vendor and an income purchaser as to what's this hybrid loan and who's gonna pay that amount. So that's yet another example of why.

But there's another reason as well, and there are numerous other examples of just things we didn't think of, quite frankly, when we first created the product. But another reason why we've amended the product now is, well, actually, I'll cite one more. It's faster. It's faster to get your money. If you don't have to worry about raising funds from individual owners, it's much faster to draw down funds from Austrata so your project can start quicker than otherwise would be the case. So that's a third.

But lastly, and we'll talk about this in some more detail, we have recently obtained, or one of our self-funding owners has obtained a private ruling from the Australian Tax Office and that ruling applies to our most recent, let's call it, version of our hybrid loan which is the one that I described before, whereby the project is initially funded by Austrata. And then once the actual cost is known, so it's not an estimate, once the actual cost is known and an owner makes a payment to refinance their share of that actual cost, that triggers then various tax consequences. And it was during two years, over two years of discussions with the ATO about this hybrid loan product that we morphed that product into what it is now as a means of best allowing us to get the outcome that we did from them.

We've actually done a whole bunch of analysis that compares the owner's interest cost during the project period. So paying their share of Strata loan interest during that project period and comparing that against what their interest cost if they were drawing down on their mortgage offset, for instance, and paying a special levy upfront. And you know what? In some, if not all, circumstances, it's actually cheaper.

You pay less interest because you're only paying interest on the share of the loan when it's drawn. And with Austrata, you only pay interest when the actual funds are utilised. And it's something that people don't really appreciate.

When a project is being funded by a special levy, those monies need to be paid upfront because builders need to see in the account. So it's not unreasonable to say that if you're paying a special levy, your money could be sitting in the body corporate’s bank account for 1, 2, 3, 6 months or more whilst you're waiting for everyone else to pay their levy before the building contract can be signed.

**Amanda Farmer:** So let me just clarify before we leave this, and I do want to get into those tax rulings. Even if you are a self-funded owner or intend to be a self-funded owner, there is a period of time in those initial stages of a project when all the costs haven't yet crystallized, let's say or are being confirmed. There is a period of time where you will contribute towards the interest payments on the Austrata loan. Is that right?

**Andrew Boss:** Yes, that’s right.

**Amanda Farmer:** Okay.

**Andrew Boss:** Yes, you will. Yes. And we make no secret of that. And during our presentations, which incidentally, we have a mandatory presentation to owners, which is typically done online and we record that so that if anyone can't make it to a session, they can watch it back later. But we actually show some of the comparisons and we're developing some explainer videos right now, which will have some of these comparisons so people can actually have a look and say, “Okay, so if I'm using money off my mortgage offset, that kind of costs me 6% or 6.5%, whatever you're paying on your mortgage at the moment, or maybe you're taking money off term deposit at 4% or 5%.” So that's your cost of paying via a special levy.

And let's compare that now with your share of the interest cost on a straddle land on a progressively drawn basis. And it takes some convincing for people and oftentimes, particularly for more financially literate owners. Once they see it, and we're kind of happy to share the spreadsheet as well, play around with the assumptions all you like. And oftentimes it's cheaper or there's very little difference between them. But the more information we provide to owners, the more informed they are when they're making a decision on what is oftentimes a really significant financial event for them.

**Amanda Farmer:** And I think it's important at this point that we very clearly acknowledge that everybody's financial position is going to be different. Everybody has different positions when it comes to taxes. And it's so important that when you're making this decision, whether you are going to be a self-funded owner or not, you do that talking to all the right people, which I'd say should include your accountant and other financial advisors who know what your specific financial position is.

But let's move into these tax rulings. Can you tell us, Andrew, I think there were two questions that were answered by these rulings. What were the question marks around the tax position and how were they answered in these rulings?

**Andrew Boss:** So the first question, and let me be really clear, this is a private ruling application from one taxpayer. So I need to be really clear, and we make this point in all of our presentations. This is a private ruling application made by a taxpayer who intends to be a self-funding owner. So the first question was, “Is interest under the self-funding owner loan to the body corporate accessible for income tax purposes?” That was the first question.

And the answer was no. So that means that there is no accessible income attributable to the notional interest income. And we had numerous meetings and discussions and literally reams and reams of paper that we submitted to the tax office explaining what the product was and why it was that this self-funding owner payment had to be by way of a loan and more to the point by way of an interest bearing loan to the body corporate.

So they understand it. They understand it. And the really positive part in the private ruling and the reasoning for the private ruling is their determination is based on a technical interpretation of tax law rather than a subjective or discretionary, which arguably could be overturned in the future. So it was a terrific outcome that there is no assessable income. We acknowledged it way back in October 2021 when we created the product that there would be a risk.

**Amanda Farmer:** And you're talking about this is the payment that comes to a self-funding owner by way of a credit on their levy account in order to cancel out that otherwise debit that's appearing for the loan.

**Andrew Boss:** That's exactly it. I mean, if you think about the hybrid loan, and we say this to people this is an engineered product that overcomes restrictive strata legislation. That's exactly what it is. And the essence of it is this. The self-funding owner charges interest to the body corporate just so the body corporate can charge interest back to them by the limits. That's it in its simplest form and the ATO gets it. And in the private ruling for that taxpayer. And I'll talk a little bit more about other owners in a second, once we cover off the second question.

So the second question was, and the prospective self-funding owner, the taxpayer in question for the private ruling application is an investor owner. And the nature of the works being conducted are repairs in nature. In fact, his particular apartment is unable to be tenanted right now until this project is completed. So the question was, “Is the payment that is made by way of a loan, so is this self-funding owner loan payment to the body corporate, is it deductible for tax purposes because he's an investor?” And the answer is yes.

And it's deductible in the year in which the loan payment is made. So for investors, that's the outcome that an investor needs as well. So it's kind of akin to the payment being made or the loan payment being made being akin to paying a levy invoice effectively.

**Amanda Farmer:** And are these self-funding owners making that payment of their total share in one lump sum?

**Andrew Boss:** Yes.

**Amanda Farmer:** Yes. Okay.

**Andrew Boss:** That's the new product. It's a one-off event. So, once the project is done, and you know, all the dollars and cents are tallied, we will then for each scheme, we hold a Q&A session for prospective self-funding owners. And we will have sent them out a schedule numerous weeks ahead of that saying, guys, here's the total amount. So here's a comparison of what your lump sum payment will be versus ongoing quarterly levies.

So for every lot owner or for every lot number, we do that to protect privacy. We say, here's a schedule. Now, if you're interested in becoming a self-funding owner, come along to the information session and bring along your accountant, bring along your lawyer, bring along whomever you want. Anyone can ask questions. And in fact, we encourage advisors to come along.

Indeed, we've had lots of them come along to our sessions over the last couple of years. And we actually show them our portal and what's involved in terms of the document execution and the like. We're actually midstream in a project with DocuSign at the moment to try and make that process or will make that process as seamless as possible. And that's consistent with us being a digital end-to-end business too.

**Amanda Farmer:** So you're really operating, tell me if I'm wrong, like a traditional strata loan provider, providing an interest-only loan up until that point where the project is almost complete, all the costs have crystallized, and then you're going to owners and saying, you've now got an option, and your option is, pay your share of the loan upfront now, and your other option is to take part in the staged repayment process which includes principal and interest over x number of years I imagine it is and some owners can opt-in and become self-funded pay upfront and others pay in time.

**Andrew Boss:** Yes, that's exactly it. And it's probably worth calling out as well that we've had approaches from some strata schemes who are now getting wind of this as well. And their project works were done or are currently being done or they were done six, 12 months ago and they're saying, we've got some of our owners who we want to pay out our share, can we do that? And the answer is, yes, you can, you know, we can refinance other loans.

**Amanda Farmer:** Yes. So they essentially refinance a loan they've had with another strata loan provider with you guys.

**Andrew Boss:** Yes, and it might be a loan from XYZ for a million dollars that gets refinanced with a loan from self-funding owners for half a million and a loan from Australia for half a million under the hybrid loan umbrella.

**Amanda Farmer:** And just to tie off this second tax ruling that was obtained, private ruling, that was in relation to the self-funding owner who's then making that lump sum payment that is deductible in the year in which it's made.

**Andrew Boss:** Yes, because he's an investor and specifically, we're really careful. We're not tax agents. Everyone's tax circumstances are different. But he was an investor and the nature of those works for repairs in nature. So otherwise giving rise to being immediately deductible. If the nature of the project is something, you know, an upgrade or whatever it is, then there are different tax consequences. Yes, you may have to capitalize it and depreciate it over whatever number of years. But the key point here is that the treatment of that outlay is effectively the same as if a special levy or a levy invoice was being paid. But once again, we say to people, you really need to consult your tax agent when you're making this sort of decision.

Now the one point I will make, and I made this point to a bunch of owners in a presentation last night was if you want the surety of having your own private binding ruling from the ATO, we will facilitate that. We absolutely will. And in fact, we've prepared the documentation. It's all templated now such that all we need from an owner is for them to sign and date an application. And we will provide all of the, to use the tax terminology, the facts and circumstances to accompany that application and the critical part of the application or all future applications that we submit is going to be the private ruling that's already been issued. The facts and circumstances are the hybrid line documentation.

So, yes, we will absolutely do that. During discussions with the ATO, they are aware. I don't think they're necessarily over the moon about the fact that they might receive dozens if not hundreds of these applications, and they might. And we'll certainly facilitate them. But they're encouraging us, or they've indicated that arguably the best course of action here is for us to submit a product ruling for the product itself, which then would obviate the need for individual taxpayers to get a private ruling. So yes, we'll do that. But experience, our prior experience has shown that probably won't happen in a hurry. We'll start the process, but that might be something that happens later in 2024.

**Amanda Farmer:** Well, it sounds like what you've done, Andrew, with Austrata, is your word, engineer this solution to combat the otherwise quite restrictive strata legislation and essentially solved a problem that perhaps others for many years have put in the too-hard basket. And having talked to you a few times now. I have some sense of how hard this problem has been to solve. So well done putting the time and the effort in. I understand you've been talking to strata lawyers as well who have signed off on this method of doing things from the strata law perspective. Can you speak a bit to that?

**Andrew Boss:** Yes, I mean, that was obviously critical during the development of the product way back in 2021. We had four or five different lawyers participating, pretty much simultaneously and pulling together the feedback from each of them was critical. Banking and finance law, compliance law, and a bit of tax thrown into the mix, but at its core, strata law, obviously.

And Colin Grace here in New South Wales. And also from a Queensland and Victorian perspective was participated really heavily in the design and development of the product. In recent times, and in response to some of the, let's call them some of the challenges that have made their way into the press, we've obtained even further. I won't even call it more robust, but what we now have is a written opinion that's shareable with prospective customers. And in Queensland, that's from Grace Lawyers in New South Wales, whilst Column is on sabbatical. We had a discussion with David Benamon and we now use Benamon's. So we've got a written opinion from David that the product conforms with the SSMA here in New South Wales and also the Property Stock and Agents Act. And we have a similar written opinion in Victoria and the ACT where we currently operate. And indeed, if we move into other states, we'll do the same. We'll find a local strata lawyer to review all of our documentation and our motions and sign off that everything conforms with relevant legislation.

**Amanda Farmer:** Good to hear. I know since speaking to you last, Andrew, I've been hearing from buildings, from owners, committee members, and also strata managers who have taken on loans through Austrata, who've been thinking about it. Sometimes I hear from strata managers that they've been a bit overwhelmed by what they see as an additional administrative burden. You've already told us a little bit about how that's being solved or has been solved with this new version of the loan. Did you want to speak any more to how you're recognizing and solving those administrative burdens?

**Andrew Boss:** Yes, it's a new product and it takes some understanding. It absolutely does. And that requires some investment from strata managers and from their back-office personnel. And you know, it's been interesting. We've had some strata management firms not embrace the product because for them it was a little too complicated. And that's okay. We understand that.

But then there are other firms who, I guess, acknowledging that the product provides a solution for their customer, for our mutual customer, and that it gives choice to individual apartment owners. They've said, yes, okay, we're willing to invest the time and the effort in understanding or in embracing and understanding what this product is. And what experience has shown is, yes, it does. It requires some time and effort, but once you kind of make that investment, then beyond that it's not much different at all to a standard strata loan.

Having said all of that, we acknowledge that strata managers are our partners just as much as our customers, the body corporates themselves. So we are currently midstream in developing, I think it's eight separate explainer videos, for one of a better term. Some of them are aimed at customers, and individual apartment owners. Some of them are aimed at strata managers. Some of them are aimed at accountants themselves. So explainer or instructional videos, if you like. We've run numerous training sessions and we've got various guides if you like. But our belief is that a video or a picture tells a thousand words, a video tells how many more.

So we're rolling those out, February 2024, in conjunction with offering further training sessions for strata managers and their finance personnel and potentially regular seminars so as to help. And certainly, the latest version of our hybrid loan whereby owners pay at the end of the project is significantly simpler for strata managers as well. It's easier for us. It's significantly simpler for strata managers. And that combined with the videos and some of the training off the back of that, we believe will make life even easier for them.

One point too, from an accounting perspective as much as anything to, I guess, provide some comfort to your accountants and financial controllers and CFOs and indeed directors, etc. of strata management firms.

We're engaging a prominent Big Four accounting firm to do an independent review of our recommended accounting treatment of the hybrid loan. It's a really interesting one. Say here in New South Wales, I'm Sydney-based myself, but here in New South Wales, the strata legislation doesn't actually require strata schemes to maintain a balance sheet. Now that's really peculiar and we've seen numerous cases of this where we're refinancing an existing loan and there's no evidence of a loan on a balance sheet. Now, in our view, that's kind of efficient because it doesn't properly represent the position of that strata scheme and it's very difficult to interpret if you're an incoming purchaser.

So what we're doing and it's certainly, it's part of the hybrid loan and our offering to strata managers and their accountants, we give them a full kit in terms of "Guys, this is how you have to account for this product." And we're getting the big four firm to sign off on that. And in fact, we've already run it by unofficially by prominent strata auditors and accounting firm, and they've run through it with a fine tooth comb, and verbally they've said they'd be able to issue an unqualified audit opinion.

So yes, it's just it's the last string to the bow if you like, you know, there's the tax piece, there's the legal piece, get this accounting piece and then you know, it's kind of it's bulletproof in that respect. And then concurrently what we're doing is via the videos and via some of some refinement, existing and ongoing refinement of the product, you know, we're hoping to make it as easy as possible for all parties to participate in because we truly believe it, it's going to be the norm in terms of strata lending.

**Amanda Farmer:** It's interesting to hear you mention there, Andrew, that there is no express requirement in our New South Wales legislation for a strata building to run a balance sheet and indeed that's the reason why I see purchases who buy into buildings that have strata loans that say, "What? I didn't have any idea that this loan was on the books.", because if you don't understand looking at the expenses where you may see loan repayments and being able to recognise those and being able to ask, hang on, where's the money for this rectification work coming from? You don't see it. It's really hard to find. And it can come as a surprise to owners buying in that there's a loan on the books.

**Andrew Boss:** Yes, it's really interesting. And it's one of the things that we developed in the latter half of last year was a loan disclosure statement to accompany what's known in New South Wales as the Section 184. A loan disclosure statement to be included as an appendix to the Section 184, such that an incoming purchaser has full knowledge or certainly improved knowledge of these are the this is the financial position and the ongoing commitments of the owners corporation as it is here in New South Wales and the owners.

Now, interestingly, we've had some situations where that loan disclosure statement either didn't make it or wasn't included as part of the WAI-IV certificate or it got lost in the works somewhere and an incoming purchaser indeed wasn't made aware. And that's what we're seeking to overcome. It's not strictly our obligation to make sure the incoming purchaser is made aware of this, but it's an industry issue that we want to help to resolve.

We're now leaning towards, and we're just waiting on some legal opinion in all of the states in which we operate because we'd like to be consistent. We're now leaning towards the owners approving levies or loan levies for the entire life of the loan. The benefit there being once those levies are approved, they're loaded into the strata's software. And therefore, should always be included in that disclosure statement.

These are interesting things because there are different strata software systems out there. There are different strata management firms that use these software systems differently. There are different strata managers themselves that use the software a little differently as well. I guess we're trying to do our best to help them to ensure that the owners at the end of the day get the best information possible.

**Amanda Farmer:** Last question, Andrew. Did you think it would be this hard?

**Andrew Boss:** It's a good question. We're three years in. We knew it would take time to become known in the industry and we accepted that. I think the part that we didn't appreciate was once we got in front of customers, just how long it would take for customers to make decisions. And we understand why owners take a long time and in the majority of cases, people are spending money they really don't want to. I mean this is fixing stuff and this is fixing stuff oftentimes through no fault at all of the owners. So we will understand the owners exploring all other avenues and as a result of that, it takes time.

It just takes a long time for all of these avenues to be explored before finally embarking on getting the underlying project done. So we didn't understand that at the start of our journey. We do now. And strata is what it is. Every building is a consortium of owners and all the owners are subject to the legislative provisions in each state. The owners need to collectively make a decision on whether they do the project and how to fund it. So yes, we probably understand that now. And indeed we didn't when we started.

**Amanda Farmer:** Well, thank you for your dedication to this product. In my view, it cannot be a bad thing to have this additional option out there for owners. And I'm seeing, I'm recognizing the hard work that you're putting in, the hoops you're having to jump through, the time that it's taking. And thank you for sticking with it. I'm excited to see what's next for Austrata. Thanks for joining me today, Andrew Boss.

**Andrew Boss:** Thank you, Amanda. I appreciate you providing some time. Thank you.

**Outro:** Thank you for listening to Your Strata Property, the podcast which consistently delivers to property owners, reliable and accurate information about their strata property. You can access all the information below this episode via the show notes at **yourstrataproperty.com.au**.