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PROPERTY COUNCIL of Australia

Australia's property industry
Creating for Generations

20 February 2020

Spiro Premetis
Manager
Advisers and Brokers Unit
Financial Services Reform Taskforce
Markets Group
The Treasury

By email: stampingfeeteam@treasury.gov.au

Dear Spiro,

Stamping fee exemption – urgent additional consultation required

The Property Council welcomes the opportunity to provide comments to Treasury in relation to its consultation on the stamping fee exemption, as announced by the Treasurer on 27 January 2020. We understand that this consultation has been undertaken to assess the merits of the current stamping fee exemption in relation to listed investment entities, which includes listed investment companies (LICs), listed investment trusts (LITs), and real estate investment trusts (REITs).

As discussed during the meeting held between Treasury representatives and the Property Council and its members on 10 February, we are deeply concerned that the impacts of the review are potentially much broader than the initial consultation implied and could lead to adverse outcomes for retail investors, Australian REITs and the overall efficiency and competitiveness of our capital markets. These unintended consequences can be avoided with further industry engagement on how best to achieve what the Government needs in the areas where it is relevant. Our submission sets out these concerns in further detail as well as responses to your specific requests for further information regarding the Australian REIT sector.

The property sector is an essential part of the investment landscape in Australia through ASX-listed investment entities such as REITs, which at over $160b[1] represent an estimated 7% of the total ASX index by market capitalisation (as of January 2020).[2] Although the REIT sector in Australia has proven popular with institutional investors for many years, the retail investor segment is just as important to listed REITs. Retail investors, particularly those entering their retirement phase, see the benefits of owning a stake in funds that invest in real assets and that can provide both capital growth and steady income streams.

The listed REIT sector has not seen any concerns raised regarding its performance, and its relatively strong performance over the short and long term shows how it can boost returns for retail investors:

[1] https://www.listcorp.com/asx/sectors/real-estate/real-estate/equity-reits

[2] https://www.asx.com.au/about/historical-market-statistics.htm

over the one-year and 10-year periods the S&P/ASX 200 A-REIT Index[3] returned 19.57% and 12.57%, respectively (as of 31 January 2020). An analysis of IPO performance across LITs, LICs and REITs over recent years is also instructive, with REIT IPOs of over $50m since the start of 2015 showing significant outperformance versus LICs and LITs over the medium and long-term (i.e. over 12 months and since listing). This provides a strong case for REITs to be considered separate from other listed investment entities.

We support robust and effective financial regulations to ensure that providers of personal financial advice, such as financial advisers and brokers, maintain the highest standards of behaviour and professionalism by acting in the best interests of their clients and protecting retail investors from behaviour that would lead to poor outcomes. This includes regulations that prevent the provision of advice that doesn't align with an investor's objectives, situation and needs, is misinformed or dishonest.

We understand that concerns have been raised that stamping fees paid to brokers and advisers are a form of conflicted remuneration. However, the narrow focus of the consultation to listed investment entities does not address this issue and will result in an unlevel playing field across different sectors.

In reality, there is a structural reliance by all prospective listed entities on the broker and adviser channel to distribute their offers to retail investors. A stamping fee is the remuneration for brokers and advisers to act in this regard as it is paid for services that are actually performed on behalf of the retail client.

Acknowledging the importance of regulations that impact on the provision of financial advice and retail investors, we have identified a number of issues that should be carefully considered before any changes are made to the current stamping fee ban exemptions for listed investment entities, and would welcome the opportunity for further discussion and engagement with Treasury and the Government to discuss potential options if changes are to be made.

The Property Council is concerned that a blanket ban on stamping fees for listed investment entities, without further consultation with industry, could lead to negative outcomes and unintended consequences for investors and entities that rely on listed markets for capital, and would jeopardise Australia's reputation as an efficient and well-regulated investment market. This includes:

- A distortion in the listed market as REITs and funds would effectively be constrained from raising retail capital efficiently through brokers, and investment would be skewed away from REITs and investment funds towards other listed companies which have no stamping fee prohibition and carry their own risks (e.g. early stage tech companies or prospective mining companies).
- Adverse impacts for retail investor, as mum and dad investors could be locked out of highly sought-after capital raisings to the benefit of institutional and high net worth investors.
- Significant challenges are likely to be experienced by REITs and investment entities looking to initiate IPOs, similar to what had occurred in 2013 when a number of IPOs were abandoned and those that proceeded were more costly and complex to implement. As a result of those problems, government introduced the exemption that is the subject of the current consultation.

We recommend that no immediate changes are made to the current exemption. If the Government remains concerned about the conflicts that may arise due to the payment of stamping fees, then we recommend that a proper review is undertaken which considers the stamping fee exemption across all applicable listed entities.

[3] https://us.spindices.com/indices/equity/sp-asx-200-a-reit-sector

If Treasury and indeed the Government are to make an informed decision on this issue, then we would urge that further consultations with industry are undertaken to properly assess feasible options for reform.

If any immediate changes are made to the exemption for listed investment entities, then we recommend that the exemption is maintained for the REIT sector in line with other listed corporations.

If you would like to discuss any aspect of this submission, please contact Kosta Sinelnikov on 02 9033 1998 and ksinelnikov@propertycouncil.com.au, or myself on 0400 356 140 and bngo@propertycouncil.com.au.

Yours sincerely

Belinda Ngo
Executive Director, Capital Markets

Submission

The Property Council of Australia champions the industry that employs 1.4 million Australians and shapes the future of our communities and cities. Property Council members invest in, design, build and manage places that matter to Australians: our homes, retirement villages, shopping centres, office buildings, industrial areas, education, research and health precincts, tourism and hospitality venues and more.

On behalf of our members, the core of which are the largest listed REITs in Australia, we provide the research and thought leadership to help decision-makers create vibrant communities, great cities and strong economies. We support smarter planning, better infrastructure, sustainability, and globally competitive investment and tax settings which underpin the contribution our members make to the economic prosperity and social well-being of Australians.

We have identified a number of issues set out below that should be carefully considered before any changes are made to the current stamping fee exemptions for listed investment entities:

1. Scope of the review is much broader than the initial consultation implied
2. The REIT sector's performance has not been the focus of the review
3. Potential impacts of adverse changes for Australia's capital markets and the ability of REITs to effectively raise capital
4. Potential impacts of adverse changes on retail investors access to listed investments
5. Recommendations and way forward

We would welcome the opportunity for further discussion on these issues and engagement with Treasury and the Government to discuss potential options if changes are to be made to the exemption.

1. Scope of the review

Stamping fees, as per Regulation 7.7A.12B of the Corporations Regulations 2001, refer to fees that an issuer or someone acting on their behalf pays to a financial services licensee (or their representative) that provides personal advice to retail clients in relation to an offer of shares or other financial products by the issuer.

This definition raises three critical issues of scope in how changes to the stamping fee exemption would apply for capital raisings from the listed market.

a) **Will changes extend beyond listed investment entities?**

The stamping fee exemption is not only relevant to listed investment entities, but for all listed entities. If Treasury and the Government have concerns with potential or perceived conflicts of interest that may arise between financial services licensees (which may include financial advisers or stockbrokers) and retail investor clients because of stamping fees, then that lens should also apply across all listed products, including listed companies.

b) **Will changes impact secondary capital raisings as well as IPOs?**

Much of the discussion to date on the issue has been around stamping fees paid in relation to initial public offerings (IPOs), but the definition of a stamping fee would also encompass fees paid to licensees for secondary raisings by investment entities that are already listed. Thus, for investment entities that are already listed (including a number of large REITs), the challenges that are discussed below would be just as relevant.

c) **Will changes inadvertently capture fees paid for services performed?**

While the stamping fee definition is broadly drafted, the fees paid to arrangers and underwriters of capital raisings through the listed market should not be inadvertently captured by any changes to the current exemption. The role of a lead arranger or underwriter in an IPO process is often complex, including in situations where a retail offer of securities is made through the broker or financial adviser distribution channel as a part of the overall offer to investors. Each player in the IPO process – be it issuers, lead managers and co-managers, brokers and advisers, underwriters, or arrangers – provide valuable services to ultimate investors that take up the offer, and should be appropriately remunerated for their services.

Although the current consultation is focused on stamping fees paid in relation to listed investment entities, it is nonetheless important to put the issue within the broader context of capital raisings by all types of listed entities.

The Financial Adviser Standards and Ethics Authority (FASEA) recently released its Financial Planners and Advisers Code of Ethics 2019 Guidance. Standard 3 of the Guidance states: "You must not advise, refer or act in any other manner where you have a conflict of interest or duty." If an adviser recommending a listed investment entity IPO (with a stamping fee payable) to a retail client is considered a conflict of interest, then this unambiguously would apply to the recommendation of capital raising offers across any type of listing. We therefore believe that there is no good policy rationale for investment entities seeking to list being treated differently compared to other entities in how or whether they make use of a stamping fee to incentivise brokers and advisers to recommend their offerings.

A number of regulatory changes and measures have been announced and implemented since the conclusion of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry in February 2019. These have been important changes to address the types of misconduct that were highlighted by the Royal Commission.

For example, the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019* was given Royal Assent in April 2019. This Design and Distribution Obligations regime introduces targeted and principles-based design and distribution obligations in relation to financial products. The obligations require issuers and distributors to have an adequate product governance framework to ensure products are targeted at the right people. ASIC is now also given product intervention powers to prevent or respond to significant consumer detriment. The release of the FASEA Code of Ethics Guidance is another example of an important shift in the financial services and financial advice industry.

One year on since the Royal Commission's final report was handed down, it is imperative to take into account the myriad changes within the financial services industry to determine if further changes are necessary. This is especially the case for issues that did not arise directly from the Royal Commission or as a result of serious and widespread misconduct in the financial services industry.

2. The REIT sector

As requested by Treasury, we have set out below further background on the performance of the REIT sector and the types of vehicles commonly used by REITs.

Performance of REIT sector

Much of the commentary made about the stamping fee issue has focused on the performance of listed investment products offered to retail investors. Our understanding is that these analyses have only looked at the LIC and LIT products that have come to market over recent years.

In contrast, most of the REITs on the ASX have been listed for many years, if not decades. The REIT sector has shown strong investment performance when measured across several performance metrics.

For example, an analysis of the premium or discount to Net Tangible Assets (NTA) for the broader real estate sector, broken down into distinct categories, shows that most REITs are trading at a premium to NTA (as of January 2020):

Sub-category	Discount to NTA (no. of entities)	Premium to NTA (no. of entities)	Average premium or discount
Retail A-REITs	4	5	-3 %
Office A-REITs	0	5	21 %
Industrial A-REITs	0	3	169 %
Diversified A-REITs	0	8	22 %
Specialised A-REITs	2	9	34 %
Fund Managers	0	7	163 %
Residential Developers	3	3	95 %
Retirement Village & MHE operators	0	4	151 %
Aged Care Operators	0	3	N/A
TOTAL	**9**	**47**	

Source: Moelis Australia

Note: Averages are market capitalisation weighted

An analysis of IPO performance across LITs, LICs, REITs and company IPOs over recent years is also instructive. Looking at IPOs of over $50m since the start of 2015, the relative outperformance of REITs versus LICs and LITs over the medium and long-term (i.e. over 12 months and since listing) can be seen:

	Share price increase relative to IPO price		
	1 day	***12 months***	***Since listing***
REITs			
Average	3.7%	2.6%	28.3%
Median	--	2.2%	37.5%
LICs / LITs			
Average	2.4%	(3.6%)	8.3%
Median	--	(1.5%)	3.0%

Source: Analysis based on publicly available data

The above data demonstrates that the REIT sector is distinct from LICs/LITs and other listed investment funds in terms of recent performance.

Defining REITs

Noting this strong track record of performance, there are other important distinctions to REITs compared with other listed investment entities.

While there is no official definition for a 'REIT', the ASX[4] provides a generally accepted definition for an Australian REIT as shown below:

> *A-REITs (Australian real estate investment trusts) give investors access to property assets.*
>
> *The major benefit of A-REITs is that they can provide access to assets that may be otherwise out of reach for individual investors, such as large-scale commercial properties. A-REITs may appeal to investors looking to diversify their portfolio into property with potential to receive a regular and consistent income stream.*
>
> *A-REITs are designed to generate wealth in two ways: they provide exposure to the value of the real estate assets that the trust owns and the accompanying capital growth, as well as rental income.*
>
> *The fund manager selects the investment properties and is responsible for all administration, improvements, maintenance and rental.*

The direct connection to ownership of real estate assets and the right to receive rental income are fundamental to how REITs are viewed by investors and to how they operate.

REITs are also structured differently to most other investment entities, usually being in the form of:

a. stapled securities; or
b. externally managed funds.

It is important to note that REITs, both as stapled groups and externally managed funds, make use of special purpose vehicles in order to own and managed the assets that they acquire.

<u>Stapled securities</u>

A stapled security is one where two ownership interests (a share in a company and a unit in a trust) are bound together, such that they cannot be bought or sold separately. As such, stapled REITs have the features and characteristics of both a company and a trust and cannot be branded as either one or the other.

The first stapled REIT came into operation in 1988. Since then, the Australian REIT market has matured and evolved over the last 30 years with stapled structures emerging as the mechanism for allowing REITs to expand their operations to exploit world-class expertise in more facets of the property industry.

The expansion of REITs from holding real estate (traditionally office, industrial and retail) into development activities and real estate management is a natural consequence of Australia's sophisticated firms leveraging their knowledge and skills.

The tax system has required a demarcation to be made between active income (to be taxed at 30% on a net basis) and passive income (to be taxed on a flow-through basis and concessionally at 15% gross basis for certain non-resident investors). Stapled structures in the property sector thus exist to allow both sides of an expanded and diversified business to co-exist and be taxed appropriately.

Stapling allows one common ownership structure that caters for different operating models and different scales of activity across the whole spectrum of property – from development and funds management (in the corporate side) to long-term property ownership (in the trust side). It allows groups to leverage their experience and capital across the different property sectors and cycle.

Property groups use a stapled structure because it allows REITs to undertake active business operations without jeopardising the tax flow through treatment of the passive rental income.

Importantly, stapling benefits investors by allowing REITs to:

[4] https://www.asx.com.au/products/managed-funds/areits.htm

- **be internally managed** (i.e. the unitholders also own the trustee).

- **run an integrated business platform** that includes not just passive ownership of real estate but complementary operational businesses such as funds management and development activities – this creates efficiencies for the REITs and an additional income stream where services are provided to third parties.

- **diversify into mixed use of assets** – e.g. combining retail, office, hotel and housing (multi-family, student accommodation, seniors living) in the one precinct. This is a core planning objective for many state and local governments as they look to create liveable cities.

Externally managed funds

The other structure employed by REITs is to be operated as an externally managed fund. This structure may be used as an external manager will often have better scale than the individual REIT and be able to bring more advanced back-office and analytical capabilities than would otherwise be possible – particularly for smaller funds. This would allow the REIT to simplify its operations instead of having to manage a fully functional investment team with back-office support. External managers levy fees for their services, which includes a base fee calculated from a fixed percentage of the assets under management and an incentive fee based on the manager's success achieving specific performance metrics.

3. Impact on capital markets of any adverse changes

For most issuers, including REITs and other investment entities, there are no direct channels of access to retail investors and they must rely on brokers and advisors to attract retail investor interest in their offer. When seeking to raise capital (either through an IPO or a secondary placement/rights issue), the issuer will use a lead manager or underwriter who will draw on a network of brokers or advisers to research and discuss the capital raising with their wholesale and retail clients.

It is appropriate that brokers and advisers are the source of most distribution activity to retail investors, as they have the resources, capability, training and experience, and regulatory oversight to provide the most appropriate products to their clients. They are performing an important and valuable service in the IPO process, just as arrangers, underwriters, legal and tax advisers and accountants all play crucial roles in this process. All these parties need to be remunerated accordingly if they are to continue to play their part and the listed market in Australia is to continue to operate efficiently.

Importantly, a retail client may choose not to take up an offer and thus a stamping fee would not be payable by that client. Other fee models that have been proposed, such as a flat or hourly fee for conducting research on offering by listed investment entities, would necessitate client having to pay fees even if they don't take of any offers.

In 2013, as a result of the Future of Financial Advice (FoFA) reforms package, stamping fees for listed investment entities, including REITs, were effectively banned and REITs and other property funds proposing to list were prohibited from paying a stamping fee to brokers or advisers for raising capital from retail investors.

Property funds had relied on brokers to raise capital from retail investors and the success of many REIT equity raisings depended on the broker channel being available, as there was no infrastructure in the market to raise capital without brokers.

At the time, the Property Council and its members were concerned that there was no viable way to reach the mum and dad investors that they had traditionally relied on for successful equity raisings. Some REITs had attempted to market their IPOs to mum and dad investors in the absence of stamping fees, however the workarounds were unviable due to high costs, high complexity and difficulties in implementation.

We had also flagged at the time that any sought-after investments that were over-subscribed would simply ignore retail offerings to avoid the risk and cost of trying to tap into that part of the market.

For example, one property group excluded retail investors due to the reluctance of the issuer and lead manager to implement a solution to the FoFA rules. Another REIT tried to use a complex differential pricing mechanism which resulted in the exclusion of retail investors: there was only a 10% allocation to mum and dad investors instead of the usual 50% allocation pre-FOFA. Another entity also tried to implement a differential pricing system similar to the REIT example above. Once again, the allocation to retail investors was significantly lower than usual and as a result mum and dad investors received less than half the usual allocation.

Thus, the workaround used as a result of the FoFA changes was complex, impractical, risky, time consuming and costly. Importantly, it resulted in retail investors missing out on offers.

Following industry consultation, the FoFA reforms were further amended in November 2014 and the stamping fee ban exemption was applied to REITs and other listed investment entities. This was welcomed by the property industry.

In the current consultation, failing to learn from this previous experience and simply repeating the same mistakes of prior years would be counterproductive and at odds with good policymaking.

4. Impact on retail investors of any adverse changes

Listed investment entities will often employ a closed-end fund structure, using trust vehicles like Managed Investment Trusts (MITs). This makes a closed-end fund structure the most suitable vehicle to pool capital from a large number of small investors and commit that capital to large, illiquid assets like commercial property, which are then professionally managed and expected to be held over the medium or long term. Being quoted on a listed market, listed investment entities would also provide liquidity for investors in the secondary market.

If mum and dad investors are effectively shut out of investing in listed investment entities, then they will miss out on getting exposure to large illiquid assets like commercial property or infrastructure. As a result, such asset classes will become the sole preserve of institutional investor and wealthy sophisticated investors, which would be a poor outcome for mum and dad investors.

The opportunity to invest in listed investment entities should not just be made available for institutional and sophisticated high-net worth investors. Retail investors, particularly those that are reliant on their financial advisors or brokers to recommend investment options, shouldn't miss out on those opportunities.

A ban on stamping fees for listed investment entities would effectively close off a large portion of retail investors to investing in listed investment entities, as financial advisors would instead only be remunerated when offering products to their clients that aren't banned from paying stamping fees, such as company listings. These types of products carry their own set of risks for retail investors. A stamping fee ban would reduce the diversity of products that brokers or financial advisers offer to their retail client base, thereby concentrating mum and dad investors into one part of the listed market.

5. Recommendations and way forward

We recommend that no immediate changes are made to the current exemption. If the Government remains concerned about the conflicts that may arise due to the payment of stamping fees, then we recommend that a proper review is undertaken which considers the stamping fee exemption across all applicable listed entities. In such a short time period as the current review, there are no easy solutions that ensure no adverse impacts for retail investors and the listed capital market.

We are concerned that the short consultation window on this vital issue, unaccompanied by the release of any consultation paper or document, could lead to negative outcomes and unintended consequences for investors and entities that rely on listed markets for capital. If Treasury and indeed the Government are to make an informed decision on this issue, then we would urge that further consultations with industry are undertaken to properly assess feasible options for reform.

If any immediate changes are made to the exemption for listed investment entities, then we recommend that the exemption is maintained for the REIT sector in line with other listed corporations.