PROPERTY FUNDS ASSOCIATION OF AUSTRALIA

Submission to Treasury

Consultation Paper - facilitating crowd-sourced equity funding and reducing compliance costs for small business

31 August 2015

Dear Minister

Property Funds Association of Australia - Submission to Treasury - CSEF

We welcome this opportunity to make a submission to Treasury in respect of the Government's Consultation Paper on whether to extend the crowd-sourced equity funding (CSEF) framework to proprietary companies, and ways to reduce compliance costs and make capital more flexible for small proprietary companies.

BACKGROUND

About the Property Funds Association of Australia (PFA)

The PFA is an industry body representing the Australian unlisted wholesale and retail property funds sector, currently some $79 billion in size.

The PFA's members consist of Australian Financial Services Licensed property fund managers, their advisors, consultants and representatives.

The PFA supports measures that encourage investment into unlisted property or other direct asset funds (including infrastructure). These measures include appropriate disclosure for investors that is relevant and transparent, regulation that supports a "level playing field" with other investment types and alternative market structures that enhance access to these types of investment.

Importance of the unlisted property funds sector to the economy

Unlisted property funds can form an important part of an investment portfolio for institutional and retail investors. Unlisted assets often provide protection against movements in the listed market, as they have not been highly correlated with the listed market. Unlisted property funds also tend to provide more stable returns, by providing investors with regular distributions from rental income.

Investments in unlisted funds have a longer investment horizon which will accord with the investment preferences of many Australians given the aging demographics of the Australian population.

Unlisted funds are often used to house investments in social infrastructure related assets including: child care, student housing, hospitals and the like – and as such measures to encourage private investment into these vehicles are crucial in reducing the future, growing impost on the public purse.

Therefore, it is important that government policy creates a robust and efficient framework to support continued investment in unlisted property funds, including supporting the ability of investors to access advice and investments, while at the same time offering necessary protections.

Our submission sets out the PFA's views as to the key issues which should be open for discussion to foster a robust unlisted property funds sector in Australia. I would like to acknowledge the Issues and Regulatory Committee and Hall & Wilcox for preparing this submission on behalf of the PFA.

We would be pleased to assist the Treasury and be involved in any further consultation in relation to these matters and other proposed reforms which may impact the unlisted property funds sector.

Yours sincerely

Paul Healy
Chief Executive Officer
Property Funds Association of Australia

Introduction

Generally, we support the Government's initiative to introduce a CSEF framework in Australia and a new regime for public and private companies to provide easier access to capital and reduce the compliance burden for start-up businesses. This will enable start-ups to utilise new technology to be able to raise smaller amounts of funds from a wider number of investors, while maintaining basic investor protections.

The PFA supports the particular model proposed by the Treasury, which would introduce a regulatory framework and platform for CSEF issuers, intermediaries and investors, including:

- increasing limits on the number of shareholders that a proprietary company may have;
- increasing the amounts that can be raised without the use of a disclosure document;
- providing relief from compliance costs such as audit requirements;
- introducing the need for an intermediary to hold an Australian Financial Services Licence ; and
- introducing caps and limits on investment by investors.

However, in our view there is a significant omission from the Discussion Paper released in December 2014 and the current Consultation Paper because they do not appear to contemplate the application of the CSEF framework to trust and managed investment scheme structures.

The stated purpose of the CSEF framework is to encourage entrepreneurship and improve the funding options for small businesses and reduce regulatory burdens that stifle innovation and growth. We commend the Government for pursuing this initiative but consider that it needs to be applied more broadly if it is to achieve its purpose.

A large component of the unlisted property industry operates through real estate investment trusts (REIT) and traditional property trusts and we do not see why start-up property businesses in their crucial early-growth stages should not be able to access CSEF in the same way as has been proposed for proprietary companies. Moreover, we are now seeing a rise in more innovative MIS that allows retail investors to access a broader range of investment opportunities, including equitable ownership in property. These more innovative MIS should also be able to access the benefits of the proposed CSEF framework.

For these reasons, we believe that Treasury should be looking at CSEF from a broader viewpoint than simply public and proprietary companies and look to expand the application of the CSEF framework to trusts and other managed investment schemes.

Obligations on managed investment schemes

A lot of the issues flagged by the Consultation Paper in relation to small proprietary companies are also equally applicable to MIS. In particular, there are obligations dependent on the number of members in a scheme (similar to the proprietary shareholder limit), and the 20/12/2 rule which applies to MIS and proprietary companies alike.

In order for registration to occur for MIS (which may be mandatory under section 601ED of the Corporations Act 2001 (Cth) (Act)) the Act requires (amongst other obligations) that the MIS:

- is operated by a responsible entity which must hold an Australian financial services licence and be a public company; and
- adopts a constitution and compliance plan which meet the requirements of the Act and ASIC regulatory guidance.

Just as the compliance obligations imposed under the Act on public companies are onerous, so too are those imposed under the Act for a registered MIS. We believe that for small schemes, the imposition of such compliance obligations can stifle the use of such a vehicle and prevent innovation for new sources of equity crowdfunded property projects (and innovative MIS more broadly). Further, it detracts from the ability for retail investors to be involved in specific property ventures where a MIS, as opposed to a company, is the most suitable structure from a tax efficiency perspective and thereby limits the ability for retail investors to have equitable ownership outside of a general REIT.

Whether a MIS needs to be registered is often determined by the 20 member cap. Importantly, if there are more than 20 members of a MIS it will be forced to be registered pursuant to the Act (unless an exemption applies).1 This is generally seen to have two consequences for the managers and investors of small property schemes:

- the MIS will only seek investment from wholesale investors in order to raise the required amount of capital without breaching the 20 member threshold; or

[1] *Corporations Act 2001* (Cth) s 601ED(2).

- the MIS is open to retail investors but the project may fail without enough capital being able to be raised from 20 different members.

Further, the MIS may still be unregistered even if the 20 investor limit is reached if a PDS is not required under the Act to be given to its members.2 This is essential as the 20/12/2 rule (as set out paragraphs 43-45 of the Consultation Paper) also applies to MIS. This means some operators of unregistered MIS will only offer an interest in the MIS to investors which are covered by the personal offers definition and not offer contemporary crowdfunding platforms to retail investors.3

Suggested changes to apply to MIS

In light of these considerations, and consistent with the proposed changes to facilitate the application of the CSEF framework to proprietary companies, we believe that the CSEF framework should also be extended to MIS to encourage more innovative forms of start-up investment opportunities via MIS where that is the more appropriate investment vehicle structure than a company.

Specifically, we suggest that Treasury should consider the following amendments to the Act to facilitate CSEF for MIS:

- increasing the member limit before a MIS is required to be registered. This should be unlimited if investor monetary caps apply;

- increasing the personal offer limitation under the 20/12/2 rule for small scale offering exemption to at least $10 million or higher;

- waiving audit obligations until the MIS reaches a certain size; and

- waiving the requirement for a product disclosure statement where the other requirements are met and instead requiring the provision of an abbreviated disclosure document which summarises the requirements of ASIC Regulatory Guide 46.

Any amendments to the Act to facilitate CSEF for proprietary companies should also be applied to MIS where it is relevant to do so.

[2] Ibid.

[3] Ibid s1012E.

The PFA understands that there are those that may argue that property as asset class does not lend itself to the type of innovation that exists in the venture capital industry but we would not agree with that view. There are a number of equity crowdfunding platforms for P2P lending and property and extending the proposed CSEF framework to MIS would facilitate more innovation in these traditional areas and support start-ups and the application of new technology to fund raising for more traditional asset classes such as property.

The PFA welcomes this opportunity to provide its views to Treasury on the Consultation Paper and any opportunity to provide further information. Please do not hesitate to contact us if you have any queries.