

## **Executive Summary**

This paper examines how tax effective Remote Location Housing Investments, (RLHI) for individuals or corporations wishing to diversify their portfolio into a valuable yet relatively little known asset class, and at the same time promote the economic independence of remote indigenous communities..

Tax effective investments are not new. It is a traditional method of investment in emerging agricultural products such as livestock and vine produce – products for which Australia has a recognised reputation and economic advantage. There are also specific tax-privileged investment schemes in the film production and forestry sectors. There are also non-resident pension funds that are tax exempt in their home jurisdiction and are exempt from income tax on the disposal of investments in eligible venture capital investments.

If smaller retail investors were allowed to purchase small lots, or units, made available by larger Housing/Construction corporations, who would manage the business on their behalf, the investor then could be deemed to be carrying on a business, the entire investment could be claimed as a tax deduction within 1-3 years. This is in clear contrast to other investments which are capital in nature and as not available as tax deductions.

The expected returns from RLHI investments are found to be above and ordinary property and below shares. Once tax incentives are balanced with the risk factors to be taken into account, it becomes an attractive asset class.

Certain risks are identified in this paper, though we also describe how these risks are managed and mitigated by modern construction methods and stock management. It is expected that this potential investment, if controlled by Tiwi leadership and emerging entrepreneurs, will bring greater prosperity to the community.

## **What does it mean today to say that groups of people or their activities exist outside the market?**

The fundamental concern for the Tiwi island economy and all remote indigenous communities is that the find ways to fully participate in the market economy. The issue is not necessarily that too little money flows into these communities; it is what consumers, public services and businesses do with that money. Too often it is spent on services with no local presence, and so immediately leaves the area.

Our starting point is the energy for changing the local economy from within a community, and the natural resourcefulness, skills and passions of local people. The principle behind this approach is that people who live and work in a place, and others who care about its future, are best positioned to find enterprising solutions, implement them and reap the rewards.

In too many remote indigenous communities, local energy and creativity become trapped, and different parts of the economy - local businesses, voluntary sector agencies, and the public sector - do not talk to each other to maximise

local opportunities. For the local economy to undergo durable and robust change, the capability and energy of everybody needs to be harnessed. Promoting and supporting local enterprise should be part of any strategy for economic regeneration. Local enterprises are more likely to employ local people, provide services to improve the local quality of life spend money locally and so circulate wealth in the community, promote community cohesion and, by reducing transportation of goods from across communities, are likely to have a smaller environmental footprint. The approach also recognises that communities do not develop their local economies in isolation.

There are no 'fundamental' reasons why the Tiwi islands community can not become a flourishing economic unit. The means of wealth creation are already present, we have land, labour, capital and enterprise. It is clear that some development needs to be made to all four of those groups. At present the land is in abundance and water is plentiful. To engage 'labour' to become more productive is a key challenge. At present the major compaction for the Tiwi labour market, in terms of unskilled low levels of English, is south East Asia, and the price of labour in that region is dramatically cheaper. If we look at capital this is an area where the Tiwi leadership are surprisingly astute at attracting large investments and while passing on most of the risk to the investor. The final challenge would be to engage the local leadership in enterprise. This will require some multi-generational leadership to target those who can handle the risk and the rewards that come with wealth creation. It is essential if the Tiwi island community is to grow into a self sufficient economic entity that it move beyond providing 'secondary' services for the outside world, such as art and tourism, while remaining dependant on the outside community for all their own primary needs, like food and housing. Raising up a culture of enterprise is needed for locals to seize these opportunities and create new streams of wealth and employment.

### **Turn Tiwi Capital into Live Capital.**

What does it mean today to say that Tiwi capital exist *outside* the market? What makes live capital? According to Hernan De Soto live capital is created by devising techniques of representation. Representations of material goods transform their value into abstract forms, which can live an "invisible, parallel life" alongside their physical existence. The West has invented procedures to create these invisible forms. Individuals in the West can unlock the assets accumulated in physical property, transforming material wealth into abstract capital. Using a house as collateral for loans, says De Soto, is an important source of credit for launching small businesses, providing a large reserve of funds to stimulate economic growth. The most important difference between successful capitalist economies and the rest of the world lies not in the wealth they possess, de Soto argues, but in how that wealth is held. The rest of the world holds its assets in "defective forms." The absence of property title and the mechanism of credit it enables are the principal reason for the failure of capitalist development outside the West. De Soto's arguments gained wide support and the concept is present in the current moves to introduce some form of '99-year-lease' in remote townships.

Critics claim that the overturning of Aboriginal community ownership of their land is not about private home ownership on remote communities. It is just a foot in the door strategy to overturn community land tenure. They claim that while in theory private home ownership could increase the housing stock it is not realistic, given that Aboriginal families on these remote communities have the lowest disposable incomes in the country, and houses in remote communities are the most expensive to build.

These are valid points, but the theory is that with more private home ownership and competition the price of housing stock would come down. If Private companies can come in and build at prices 40% 60% cheaper than the government then that will in the long run help these communities.

### **What are the Risks?**

De Soto's researchers found their most impressive results in Egypt. They estimated that as much as ninety-two percent of the country's housing was held in defective forms, representing \$248 billion in under-used assets, they said this dead capital represented more than fifty-five times the amount of all the direct foreign investment ever recorded in modern Egypt, including digging the Suez Canal in the nineteenth century and building the Aswan High Dam in the twentieth.

The result was a disaster. In rural Egypt small farmers faced rapidly rising prices. Tax payments increased sharply, to cover mortgage payments on the estates of the ruling family. A cattle disease which killed most of the country's draft animals, caused further difficulties. To obtain loans to survive such crises, farmers now had to mortgage their own land. Creditors were able to use the new powers of foreclosure to seize the assets of those unable to keep up debt payments. Farmers described the courts that enforced foreclosure decisions as "a machine for transferring the land" from small farmers to the wealthy. Creditors could take possession of not only the fields but also draught animals and ploughs, and could seize or demolish debtors' houses.

The movement of assets from what is called the outside to the inside does offer a means to create wealth. The process of property titling and the use of property as collateral offer up opportunities for speculation, for the concentrating of wealth, and for the accumulation of rents. The assets of the poor are the means through which this reorganization and accumulation of wealth is carried out.

While the poor remain "outside" this process, the outcome of a process of property titling and the mortgaging of property is that land and housing become even less affordable to the poor.

They are further excluded from opportunities for the accumulation of capital. Yet at the same time they are "inside" the process. It is their houses and their lives that must be transformed in order to carry out the production of this

wealth. If the Tiwi Islanders are to gain from the new land tenure that is created on a very small proportion of their land then they must be simultaneously empowered to take risks and create wealth. It is essential that the leadership on the Tiwi Island form strategic partnerships with outside groups to create sustainable business.

An initial starting point could be providing housing. Construction is always a great catalyst for stimulating economic growth. For this to work the Tiwi must take control and only employ outside skills and capital when it can not be found internally and always with a view to moving toward full Tiwi participation.

### **What are Remote Location Housing Investments?**

RLHI are simply investments into the housing market in specific geographic zones deemed to be remote.

Australia has since its inception as a nation been hampered by vast distances and small population. There have been constant calls to populate or perish. This program of remote economic zones is designed to encourage capital and economic development and therefore population, into some of the most remote areas.

Until recently, investments into remote housing have only been made by the public sector. This has meant that housing stock has been "supply driven", rather than "market driven". However in the last 10-15 years there has been a significant shift in policy thinking, it is now recognised that the only real solution is to partner with the private sector. Only by allowing a free flow of private capital will there be the chance of supply meeting demand.

This proposal is about making investment parcels available to the "retail" investment market. This is achieved through the use of *Managed Investment Schemes*, which pools the capital from a large number of small investors, allowing people with as little as \$10,000 to participate in large scale RLHI projects.

### **RLHI Managed Investment Schemes**

RLHI Managed Investment Schemes are similar to traditional property and share trusts. A large number of investors offer capital for direct use in an economic enterprise, and that enterprise is managed by qualified professionals who are paid a management fee. Profits are distributed to the "beneficiaries" as investment returns.

Example: A construction is planned for 3 months time, and investors are sought to participate in the project. To participate, each investor must purchase a minimum number of units. Thus each investor is in fact deemed to be carrying on a business, with that business being managed by a third party.

### **How They Work**

Although details will vary among specific investment projects, a typical flow will be as follows:

A construction company may purchase land, or enter a partnership with the current owners. The construction company will have the motive of creating a new market for their product. The company will be simply using the RLHI

to fund the supply of their product to the market.

Investors purchase a number of "lots" in the project. It should be possible to purchase units in a trust that holds the title of a specific lot. The investor signs a lease and/or management contract with the "responsible entity" to manage the ongoing operation of the land and property management.

At this point, the investor is deemed to be carrying on a business in RLHI, assuming the business is structured and managed consistent with the relevant ATO ruling.

Assuming this is the case, the investor obtains a full tax deduction of the investment amount. This could be 100% in the first year, or 80% in the first year, and 10% in the next two years, depending on the project.

Over the next few years, the responsible entity manages the business, taking responsibility for ongoing operation, yields, legal compliance, insurance and risk management, sale and final delivery of the housing stock.

Investors receive income according to the contract. This will differ by the nature of the product. Construction projects will deliver a one off payment after sale to the end user. Managed Housing Trusts may take a few years to reach optimal yields, but thereafter, payments may be made annually. Payments will be made to investors in proportion to the number of lots they hold.

### Typical Investment Case Study

We describe here a hypothetical scenario to illustrate how an RLHI may work.

Scenario: Investor makes a \$4 Million profit, so invests in a \$4 Million RLHI project to completely remove this year's tax bill. She decides to finance the full amount, including GST, and so make the tax savings available of other investment.

Without any tax planning, the individual faces the following scenario

Taxable Profit	\$4,000,000
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Potential tax bill	\$1,920,000
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By investing in the project, her tax position changes drastically:

Value of RLHI investment	\$4,000,000
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when offset against profit, final \$0

taxable profit

tax saving	\$1,920,000
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In addition to the tax saving, the GST is also refunded.

Value of RLHI investment	\$4,000,000
Amount required including GST	\$4,400,000
amount borrowed	\$4,400,000
GST refund	\$400,000

Thus the total cash available to the investor is now \$2,320,000 as follows:

tax saving	\$1,920,000
GST refund	\$400,000
total cash available	\$2,320,000

The expected return over 10 years of this particular forestry investment was independently estimated to grow at around 15% pa.

Initial value of RLHI	\$4,000,000
term	10 years
expected growth rate	15%
Expected final value of investment	\$16,180,000

This cash can then be used for other investments. In this example, the investor may purchase a Classic property geared to 55%

Value of property	\$5,000,000
Borrowed funds (55%)	\$2,750,000
equity (from tax savings)	\$2,250,000

During the next ten years, the property would be expected to increase in value to 2.5 times its original purchase price, to \$12,500,000.

Total anticipated future value of the investment can now be easily calculated as the sum of these two independent streams

Classic property	\$12,500,000
RLHI	\$16,180,000
Total anticipated value	\$28,680,000

Although potentially realistic, it must be remembered that the example is hypothetical, and a full analysis of risk

factors should be performed as part of a due diligence exercise.

### **Prospects & Opportunities for RLHI Investment**

There are currently several areas of prime interest for the types of projects described in this paper.

It is estimated that the Territory needs a further 4000 dwellings to adequately house its present population. Into the future, more than 400 houses will be needed each year for 20 years to keep pace with the demand. The increased funding commitments from the Northern Territory and Australian Governments will provide for 500 new houses per year for up to five years.

The NT Minister for Housing, Mr Elliot McAdam, noted in a ministerial statement delivered in June 2006 that the overcrowding of houses in Aboriginal communities is a serious problem, he went on to say that the "mathematics of the housing equation are that not only are we failing to meet needs – we are indeed falling behind. This is not a truth that has suddenly fallen from the sky; but a social reality that has been gathering pace for decades."

### **Size of the Investment Sector**

It is estimated that over \$7Billion need for RLHI per year. The present estimate of unmet housing market in the Northern Territory alone is \$1.2 billion – up from \$800 million six years ago. This represents 4000 dwellings and even this would only achieve an average occupancy rate of seven people per dwelling.

The market is set to continue to expand as the population in these communities is expected to double over the next 25 years. At the present rate of construction, it will take some 33 years to meet the existing unmet market demand; and by that stage, the increase in population will mean there is still another billion dollars worth of demand in the market.

### **Expected Returns**

Returns are generally expected to be around 14% to 18% depending on the project. Once risks are factored into the analysis, RLHI are generally positioned between property and shares.

The expected method is that a consortium will work from the manufacture of materials thru to construction and sale to end user. This would mean that because of the investment capital profits will be deferred and dispersed on completion.

Depending on the project, returns may take 3 years to achieve, or may be forthcoming within a year if the end user purchases directly from the project. The expected return over the life of the investment will often be estimated by an

independent research group. These companies provide detailed reports covering a great deal of information which an investor will need in order to rationally and critically assess an investment opportunity, including:

- 1 Project scope
- 2 Identification and assessment of risk factors
- 3 Critical success factors
- 4 Market and industry outlook
- 5 Assessment of the management team
- 6 Analysis of the project structure
- 7 Review of all cash flow projections, including identification of key assumptions
- 8 Assessment of expected returns
- 9 Opinion on relevance of tax ruling

Finally, the research report should give a rating of the major investment quality criteria, as well as an overall recommendation rating. Some companies provide risk reducing incentives to invest, such as offers to extend the investment period at no cost if certain minimum rates of return aren't achieved.

#### **Potential Investors Benefits.**

Investing in this class of asset has a number of benefits which may or may not apply to any single investment strategy:

***Diversification:*** RLHI risks and rewards are largely independent of those associated with traditional property, cash and shares (which is why they are considered a separate investment class). Thus RLHI business represents a valuable opportunity to diversify an investment portfolio.

***Potentially high returns:*** Although impossible to predict reliably, most projections show returns to be well above property.

***Unique tax benefits:*** Perhaps the most significant benefit of this asset class is the ability to claim between 80% and 100% of the initial investment as a tax deduction in the first year. This fundamentally separates this investment class from other asset classes.

#### **Economic Benefits of RLHI Investment**

This innovative scheme behind RLHI would make available billions of dollars of much needed capital to fund efficient, large scale housing and infrastructure projects, utilising scale economies, capital intensive rather than labour intensive methods, diversified land holdings to help spread risk.



The increase in efficiency and output and the lowering of risk are working together to create a significant expansion of the sector, including revenue, profit and job growth, not only in the constructions themselves, but also from multiplier flow-on effects to supporting services.

These factors ultimately benefit all Australians, and for this reason RLHI business is expected to to achieve favourable support from government policy makers.