GST

Residential Development Projects

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RE: GST – Residential Development Projects

The Goods and Services Tax (GST) is to be introduced on 1 July 2000. The purpose of this document is to:

- explain how Suncorp Metway think the GST will impact on residential real estate markets;
- talk about GST on development costs and claiming refunds for GST input credits;
- discuss the impact of GST on the feasibility of projects moving forward; and
- tell you about a new Suncorp Metway GST companion facility designed to minimise the impact of GST payable on development costs on our customers' cash flow / working capital facilities.

Please note that this does not constitute and is not intended to be advice (whether or not of a legal nature) to you on the GST or what you need to do about GST. This document is to principally outline our requirements for residential development projects. The information contained in this document is of a general nature only. The tax laws apply differently to different people in different circumstances and therefore you should not act on the basis of information contained in this document without seeking specific advice regarding your particular circumstances from your professional tax or legal adviser. We are not liable to you or any other person for the consequences of anything done or omitted to be done by you or any person relying on a part or the whole of the contents of this document. Any information contained in this document is based on our understanding of the law as at the date of this document.

Market Impact

The impact of the GST on residential real estate markets is not easy to assess. Real estate prices (values) will continue to be determined by the relative levels of supply and demand for real estate product in different market segments and locations. Residential real estate will not be advertised as "x" dollars plus GST. The advertised price will be inclusive of GST and it is considered most unlikely that purchasers of residential real estate will be concerned about how much GST a developer is obliged to pay on the sale of a property, particularly given the potential for different GST rates resulting from application of the margin scheme. As a consequence, it is most improbable that developers will be able to pass on the exact amount of GST payable on the supply of residential real estate. Moving past the initial market impact after the introduction of the GST, developers will not supply new product until they believe the market will pay a price (including the GST) that will show a satisfactory reward to cover project risk. **The bottom line is that the GST will probably cause additional volatility in both price and volume of residential real estate over the next year or so.**

Claiming GST Input Credits

Most development costs will increase by up to 10% (some costs will reduce as a result of the abolition of wholesale sales tax) from July. The good news is that developers will be entitled to claim an input tax credit for the GST component of their development costs. As a result, the GST on development costs should not have a material impact on project profitability. The GST on development costs or the inputs to a project are merely a cash flow management issue.

Developers will need to register with the Australian Taxation Office (ATO) and obtain an Australian Business Number (ABN). We suggest you immediately contact the ATO and take the necessary steps to obtain your ABN if you have not already done so.

In terms of GST legislation, entities required to be registered for GST must apply for registration before 31 May 2000. **The bottom line here is that you will not be able to claim GST input credits on your development costs unless you are registered and have an ABN**.

Developers will need to lodge a periodic Business Activity Statement (BAS) in order to obtain a refund of GST input credits.

The BAS is to include all the transactions of a taxpayer with the ATO: for example GST, group tax, payroll tax, company tax and fringe benefits tax. Tax payments due to the ATO will be netted off against GST input credit refunds, resulting in either payment to be made with lodgement of the BAS, or a refund to be made electronically by the ATO within 14 days of lodgement of the return. GST refunds paid by the ATO outside the 14 day period will include interest.

If your annual sales exceed $20m, you will be required to lodge returns electronically and make payments electronically monthly. Smaller businesses have the options of electronic or paper returns, monthly or quarterly and making payments manually or electronically. Returns and payments (if any) are due for lodgement within 21 days of the relevant tax period (i.e. monthly or quarterly).

We anticipate that **it will better suit most developers' cash flow management to elect monthly returns, and lodge on the first of the month when a refund is due, and lodge on the twenty-first when a payment is due to the ATO**.

NEW FACILITY

The Suncorp Metway GST Companion Facility

Suncorp Metway will offer a companion facility on all new development finance facilities established after 1 May 2000. The purpose of the **companion facility is to fund the GST paid on development costs, until the GST input credit is received from the ATO**.

No additional security will be required – the idea behind the facility is to negate the impact of GST payable on development costs on our customers' cash flow / working capital facilities.

The easiest way to explain how the GST companion facility works is to compare and contrast a hypothetical 10 unit residential project undertaken before GST, and the same project undertaken post GST.

The accompanying loan summaries, cash flow and project feasibilities show full details, the major differences are summarised below:-

DETAIL	$000 PRE-GST	$000 POST-GST	$000 VARIANCE
Land	1000	1100	100+
Construction	2000	2200	200+
GST Input Credits		300	300-
Other Costs☆	100	100	0
Interest	114	116	2+
TOTAL COST	**3214**	**3216**	**2+**
Loan Amount	2400	2700	300+
Gross Sale Price	4000	4000	0
Agents/Legals☆	120	120	0
GST on Sales	0	364	364-

☆ Much of "other costs", "agents" and "legal fees" will also be subject to GST, with the ability to claim input credit refunds. For the sake of simplicity, the GST on these inputs are ignored in the above example.

The GST companion facility increases the loan amount by $300,000 to enable funding of the GST payable on the development costs pending receipt of a refund for GST input credits from the ATO. The Suncorp Metway GST companion facility is to be progressively repaid from this source, and **customers wishing to take up a companion facility will be required by us to lodge their BAS at monthly (and not quarterly) intervals**. As a result, the balance outstanding under the companion facility should be restricted to the amount of the previous single month's GST refund for input credits on development costs.

You may check how it is intended the GST companion facility should operate on a month to month basis by contrasting the flow of funds on the accompanying "Before GST" and "Post GST" cash flow and project feasibilities. The following summary demonstrates the monthly progress payments and loan repayments arising from funding the GST on development costs and repaying the GST input credits through the Suncorp Metway Companion Facility. Please note the loan balance one month after the project completion (before loan repayments from sales) is the same as for the pre GST case. The $300,000 advanced to cover GST on development costs has been repaid through the GST input credits.

DETAIL	$000 PRE-GST	$000 POST-GST	$000 VARIANCE
Month 1			
GST on Development Costs	-	100	100
GST Input Credit	-	-	-
Loan Balance	800	900	100
Month 2			
GST on Development Costs	-	11	11
GST Input Credit	-	-100	-100
Loan Balance	800	811	11
Month 3			
GST on Development Costs	-	23	23
GST Input Credit	-	-11	-11
Loan Balance	800	823	23
Month 8			
GST on Development Costs	-	-	-
GST Input Credit	-	-24	-24
Loan Balance	2400	2400	-

Historically, Suncorp Metway Development Finance loans have not provided amounts on account of general taxes payable by their customers. Loans are project specific and customers meet their company tax, fringe benefits and other taxes through management of their cash flow through working capital facilities independent of Suncorp Metway Development Finance loans. As previously mentioned, the BAS will account for all a taxpayer's relationship with the ATO, with refunds netted off against any taxes payable by a taxpayer. The companion facility is specifically for GST and not other general taxes.

As a result, the companion facility will still need to be credited with the amount of the project's GST input credit claimed in the BAS, notwithstanding the ATO has reduced or eliminated the refund on account of other outstanding taxes. You will still be required to independently manage your working capital and cash flow to meet your obligations to pay other taxes – **the companion facility is for GST only**, and is designed to maintain the status quo from a cash flow perspective during the construction stage of your project/s.

Record Keeping for the Suncorp Metway GST Companion Facility

Suncorp Metway engages panel quantity surveyors and/or engineers to confirm expected development costs and certify progress payments. Our panel consultants will be required to change reporting formats to record development costs (net of GST), GST on development costs, and gross development costs (inclusive of GST) on initial confirmation of development costs, as well as all certifications of progress payments. The consultant's reports will be used to determine development costs and GST input credits on project feasibilities, as well as the amount of progress payments payable including drawdowns under the GST companion facility.

We may at times require a certification from a customer's accountant regarding our customer's total relationship with the ATO: particularly where a relatively large GST payment is made on the purchase of a site, or where delays in obtaining refunds on account of input credits are being experienced.

The GST companion facility is not to be an additional loan account: it forms part of the development finance loan and will be monitored monthly while advances for GST input credits remain outstanding.

Impact on Project Feasibility

Good management in claiming input credit refunds for the GST payable on development cost results in a relatively small additional working capital requirement, and a negligible negative impact on project profitability. The big impact is the GST payable by developers when the completed project is sold. You will note in the above hypothetical example, the assumption that the market did not allow for an increase in selling prices to cover the $364,000 cost of GST, and the profit falling to $300,000 or 7% as a result. While the no market increase is conservative, it serves to demonstrate the need for caution in negotiations about the price to acquire new sites as we move into the GST regime.

Feedback Please

The GST presents challenges to the real estate development industry. Our initial response in dealing with some of the challenges is detailed in this letter. We would be interested and pleased to hear your feedback on the matters raised, and ask that you contact either Garry McLean, State Manager, Development Finance Queensland, John Batiste, State Manager, Property Finance NSW or Peter McBride, State Manager, Development Finance Victoria.

Wishing you continued success in developing through the challenges of the new Millennium.