

18 August 2016

Personal

Affordable Housing Consulting Pty Ltd
Level 2
300 Flinders Street
ADELAIDE SA 5000

Dear Paul

Re: Taxation consequences of proposed changes to the fee structure

I refer to our recent meeting regarding your proposed fee structure for National Rental Affordability Scheme (NRAS) services and the taxation consequences for investors. We have considered the tax position of investors under both the current fee structure and the new fee structure and advise the following:

Our Understanding of the Facts

Affordable Housing Consulting Pty Ltd (AHC) is a registered NRAS provider and assists investors with the necessary compliance work required to ensure that they are eligible for the NRAS incentives.

Currently, AHC charges investors a facilitation fee of 12.5% of the total incentives received in relation to their services.

Under the proposed new fee structure, AHC will enter into an agreement with investors to share the State Government portion of the NRAS incentive equally.

You have advised that you have discussed the splitting of the State Government incentive with the relevant authorities and they have confirmed that this is permitted under the NRAS rules.

We understand that owners will need to agree to opt into the proposed arrangement for it to take effect.

The Australian Taxation Office (ATO) has issued a private ruling to AHC confirming that for taxation purposes, the State Government incentive received by investors will be limited to their 50% share under the new structure.

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Our Advice

Based on the above facts, we advise that the taxation consequences for investors will be as follows:

General taxation issues

The NRAS incentives consist of two parts; a refundable tax offset (\$8,187.78 for the year ended 30 June 2016), and a State Government payment (\$2,729.26 for the year ended 30 June 2016). Neither of these amounts is included in the investor's taxable income.

Whilst it is not taxable, the State Government payment will be considered to be income received in relation to the NRAS property (referred to as non-assessable, non-exempt (NANE) income). This will result in the expenses incurred in relation to the property being deemed to have been incurred in earning both taxable income and NANE income.

When determining the net taxable income or loss from the NRAS property, it is necessary to apportion the expenses between the taxable rent received, and the NANE State Government payment. This apportionment is usually made on a percentage basis.

That portion of expenses which relate to the earning of the State Government payment will not be tax deductible, however they can be added to the cost base of the property, reducing the future capital gain realised on the eventual sale of the property.

Taxation under current structure

Under the current fee structure, investors receive the full State Government payment of \$2,729 which will be treated as NANE income received in relation to the NRAS property. This amount will then be used when determining the taxable portion of the income received in relation to the property, and therefore the deductible percentage of the expenses incurred.

As the facilitation fee charged by AHC relates to the receipt of the NRAS incentives, and not to the receipt of rental income, this fee will not be tax deductible for investors.

Taxation under the proposed new structure

Under the proposed new structure, investors will only be deemed to receive 50% of the State Government payment. Therefore only \$1,365 of NANE will be added to the actual rental income when determining the taxable percentage of income received in relation to the property.

As AHC receives a 50% share of the State Government payment, there will be no non-deductible facilitation fee charged.

An example of the tax calculation under each of the above fee structures is included in Appendix A to this letter, together with a comparison of the two models.

As illustrated in appendix A, we are of the opinion that it will represent a tax benefit for investors to agree to opt into the proposed change under the shared incentive method.

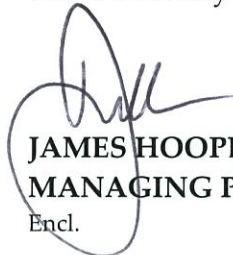
We note that this advice has been provided for information purposes. Investors should seek independent taxation advice which specifically considers their own individual circumstances.

HLB Contact for Investors

You have requested that a contact person be available to discuss the taxation effect of the proposed change under the shared incentive model.

Investors can contact Mr Andrew Burns, Manager of our Tax Consulting Division, on (08) 8133 5000 or aburns@hlbsa.com.au should they have any queries, or require further information.

Yours sincerely



JAMES HOOPER
MANAGING PARTNER

Encl.

Appendix A Analysis and Comparison of Fee Structures

The following example illustrates the taxation of the rent and NRAS incentive received by AHC investors under each of the fee structures set out by AHC. The figures in this example are merely used as a guide. Investors should perform their own calculations based on their actual circumstances.

Assumptions:

Purchase price	\$375,000
Depreciable items (75%)	\$281,250
Market rent per week	\$380
Vacancy rate & bad debts	4%

Cash position

	Existing- Facilitation Fee	Proposed - Share of Incentive	Difference
Income			
Rent (\$304 x 52 x 96%)	15,175	15,175	0
NRAS tax offset	8,188	8,188	0
NRAS State Government payment	2,729	1,364	-1,365
Total income	26,092	24,727	-1,365
Expenses			
Council & water rates	1,500	1,500	0
Repairs & maintenance	500	500	0
Letting costs (2.2 week rent)	836	836	0
Advertising	150	150	0
Property management (8.8%)	1,744	1,744	0
Insurance	800	800	0
Interest (100% borrowing @ 5.5% interest only)	20,625	20,625	0
AHC facilitation fee	1,365	0	-1,365
Total expenses	27,520	26,155	-1,365
Net cash position before tax	-1,428	-1,428	0

Apportionment of income

	Facilitation Fee	Share of Incentive	Difference
Rent (taxable)	15,175	15,175	0
NRAS State Government payment (NANE)	2,729	1,364	-1,365
Total Income	17,904	16,539	-1,365
Taxable percentage	84.76%	91.75%	6.99%

Tax position

	Existing - Facilitation Fee	Proposed- Share of Incentive	Difference
Income			
Rent	15,175	15,175	0
Deductible expenses			
Council & water rates	1,500	1,500	0
Repairs & maintenance	500	500	0
Letting costs (2.2 weeks)	836	836	0
Advertising	150	150	0
Property management (8.8%)	1,744	1,744	0
Insurance	800	800	0
Interest (100% borrowing @ 5.5% interest only)	20,625	20,625	0
Depreciation (3% of deductible items)	8,438	8,438	0
Total	34,592	34,592	0
Tax deductible percentage	84.76%	91.75%	6.99%
Net tax deductible expenses to claim	29,319	31,739	2,420
Net taxable income (loss)	-14,144	-16,564	2,420
Tax reduction based on marginal tax rates (including 2% Medicare)			
0%	0	0	0
21%	2,970	3,478	508
34.5%	4,880	5,715	835
39%	5,516	6,460	944
49% (including Budget Repair Levy)	6,931	8,116	1,185