

25 May 2023

Legislative Council Standing Committee on Economy and Infrastructure

Parliament of Victoria

Parliament House

Spring Street

EAST MELBOURNE VIC 3002

By email: [landfeesinquiry@parliament.vic.gov.au](mailto:landfeesinquiry@parliament.vic.gov.au)

Dear Committee Members,

**Submission for 2023 Parliamentary Inquiry into land transfer duty fees**

We would like to make the following Submission in relation to the Parliamentary Inquiry into land transfer duty fees.

We are the joint CEOs of Midkey Funds Management Pty Ltd ("**Midkey**").

Midkey is a home loan provider which offers a unique home loan product called a Midkey "No Monthly Payments" Loan (also known as a "Midkey Deferred Payments Loan").

Midkey launched its innovative new loan product in April 2023 (<https://www.midkey.com.au/>). The product was not available in Australia previously. Details of the Midkey loan product are set out below.

Currently, Midkey can provide loans in New South Wales, Queensland, and South Australia. It will soon offer loans in Western Australia, Tasmania, and the ACT.

As a result of a Victorian State Revenue Office ruling in September 2022 ("**Victorian SRO's Ruling**") in relation to Part 4B of Chapter 2 of the *Duties Act 2000* ("**Part 4B**"), Midkey will not be able to offer its loans in Victoria (more details provided below).

The Victorian SRO's Ruling is the only impediment to Midkey offering its loans in Victoria. If it weren't for the ruling, Midkey would've launched in Victoria when it launched in New South Wales. Notably, Victoria is the only state in Australia with duty legislation that results in Midkey being unable to offer its product.

We believe, for the reasons set out below, the Committee should:

- a. investigate urgent reforms to Part 4B (and the guidance provided by the Victorian SRO in relation to Part 4B - see <https://www.sro.vic.gov.au/economic-entitlements>);
- b. review the Victorian SRO's Ruling (and, in particular, the Victorian SRO's narrow interpretation of the economic entitlement provisions in Part 4B in relation to Midkey's loan product); and
- c. take steps to address the many negative consequences that the Victorian SRO's Ruling will cause for many Victorian residents.

### **Midkey's innovative loan product**

1. At a high level, the terms of Midkey's unique loan product are:
  - a. it can be secured by a first or second mortgage;
  - b. the timing of the loan term is similar to a reverse mortgage (i.e. in almost all circumstances, the loan only needs to be fully repaid on the sale of the property, or on the borrower's death);
  - c. all Midkey loan payments occur at the end of the loan. The amounts owing at the end of the loan are a combination of the following:
    - i. loan principal;
    - ii. accrued simple interest; and
    - iii. a fee that each borrower must pay in return for Midkey providing the service of deferring all the borrower's principal and interest payments to the end of the loan. The fee is a proportion of any increase in the borrower's property value. So, for example, if the loan's value is 10% of the property value, then the fee will be 10% of any increase in the property's value at the end of the loan. If the loan's value is 20% of the property value, then the fee will be 20% of any increase in the property's value at the end of the loan. If the property's value does not increase, this fee is not payable. We call this fee a "Midkey Deferral Fee" (also sometimes referred to as the "Deferred Payments Variable Fee");
  - d. as a first mortgage, our maximum LVR is 32%. As a second mortgage, our maximum LVR is 27% and a maximum total LVR (including the first mortgage) of 76%; and
  - e. our loans can be provided to Australian borrowers who are over the age of 18.
2. The objectives of the Midkey's loan are to:
  - a. require no payments during the loan term;
  - b. minimise the risk of rapid equity erosion by:
    - i. charging simple interest (not compound interest);

- ii. charging simple interest that is only around 1% to 2% higher than a standard mortgage;
  - iii. only lending as a second mortgage where the first mortgage is being amortised; and
  - iv. lending at conservative LVRs; and
- c. provide a sufficient return to our investors and align our borrowers' outcomes with our investors' outcomes via the Midkey Deferral Fee.
3. Midkey is ACL and AFSL licensed. It has ASIC's approval to provide its loans and has classified its loans as a reverse mortgage. Despite its classification, we note that the Midkey loan is clearly different from a reverse mortgage (ie. it can be lent to borrowers under the age of 55, it can be provided as a second mortgage, it charges simple interest, it charges lower interest than a typical reverse mortgage, and it has a Midkey Deferral Fee)

### **Midkey's Submission to the Victorian SRO**

4. EY advises Midkey on tax issues. EY made a submission to the Victorian SRO on 30 May 2022 ("**Submission**"). Please let us know if you would like us to provide you with a copy of the Submission.
5. The Submission requested confirmation that the Midkey loan does not acquire an economic entitlement for the purpose of Part 4B of Chapter 2 of the Duties Act 2000 (Vic) (Duties Act) when it is secured by a mortgage over Victorian land.
6. In the Submission, Midkey stated the reasons why Midkey should not be considered to have acquired the relevant economic entitlement. A high-level summary of the main reasons appears below:
- a. The relevant economic entitlement provisions are directed at property development agreements and were introduced to overcome the Supreme Court decision in *BPG Caulfield Village Pty Ltd v Commissioner of State Revenue [2016] VSC 172*. This case involved a development project.
  - b. Midkey does not finance property development projects. A Midkey loan must be secured by a completed residence.
  - c. The Midkey Deferral Fee is a genuine fee for service. This fee enables Midkey to provide a market-based return to its investors while charging its borrowers a low, simple, accruing interest, with no fixed loan term.
  - d. In essence, the Midkey Deferral Fee is another form of interest payment. The percentage used to calculate the fee represents the risk and compensation for the time value of money costs.
  - e. A comparison of second mortgage providers indicates that the combination of i) Midkey's simple interest and ii) the Midkey Deferral Fee provides the borrower with a total cost outcome that is within or even below industry standards.

- f. If the Midkey loan is subject to Victorian stamp duty, Midkey will not be able to offer its loan in Victoria. This is because, in terms of the financial viability of Midkey's loan business:
  - i. Midkey's investors are not able to absorb Victorian stamp duty costs; and
  - ii. Midkey could not restrict the provision of its loans to only sub \$1m residences in Victoria, as it would be uneconomic and cause significant marketing difficulties for Midkey.
- g. If a borrower's property does not increase in value during the Midkey loan term but instead decreases in value, Midkey will not participate in any downside in the value of the borrower's property. Therefore, it cannot be said that Midkey obtains an interest in a borrower's property that is equivalent to an owner's interest.
- h. A Midkey loan is a genuine financing arrangement between a lender and a borrower. A Midkey borrower retains full legal and beneficial ownership of their property. Midkey does not obtain any direct or indirect entitlement to or beneficial ownership of the borrower's property.
- i. Midkey's full-time business is providing loans at commercially fair costs.
- j. The relevant economic entitlement provisions are anti-avoidance in nature. There is no duty avoidance motive behind Midkey's genuine financing business.
- k. Stamp duty payable in Victoria is determined by reference to the unencumbered value of the property. There is a practical difficulty in calculating duty as the Midkey Deferral Fee because the fee amount will only be known at the end of the loan.

### **Victorian SRO's Ruling**

7. On 29 September 2022, the Victorian SRO applied a narrow interpretation to the economic entitlement provisions in Part 4B in relation to Midkey's loan product and ruled that Midkey will be taken to have acquired an economic entitlement in relation to Victorian land. This was because the Victorian SRO viewed Midkey's entitlement to receive the Midkey Deferral Fee as representing an entitlement to:
  - a. participate in the capital growth of the relevant land, and
  - b. participate in the proceeds of sale of the relevant land.

Please let us know if you want us to provide you with a copy of the Victorian SRO's Ruling.

### **Reasons why the Commissioner's decision should be reviewed**

8. As mentioned above, Midkey believes, for the reasons set out in the Submission (see paragraph 6 above) and the reasons set out in paragraphs 9 and 10 below, the Committee should:

- a. investigate urgent reforms to Part 4B (and the guidance provided by the SRO in relation to Part 4B - see <https://www.sro.vic.gov.au/economic-entitlements>);
  - b. review the Victorian SRO's Ruling (and, in particular, the Victorian SRO's narrow interpretation of the economic entitlement provisions in Part 4B in relation to Midkey's loan product); and
  - c. take steps to address the many negative consequences that the Victorian SRO's Ruling will cause for many Victorian residents.
9. When reviewing Part B and the Victorian SRO's Ruling, Midkey urges the Committee to take into account the following information:
- a. **Social benefits:** The Midkey loan is the only regulated loan available to borrowers under 60 that does not require regular payments. Because a Midkey loan does not require regular payments and has no fixed repayment term, it can be provided when traditional lenders are normally constrained by serviceability tests. This means that a Midkey loan is often the only source of capital available to its borrowers. These borrowers could be facing significant personal financial issues that can't be solved via traditional debt providers. As examples, a Midkey loan could enable these borrowers to avoid the sale of their primary residence in order to:
    - i. reduce the amount of their regular interest-paying debt – this is particularly important in the current environment of rising rates and a rising cost of living;
    - ii. pay or continue to pay for private school education for their children;
    - iii. complete their home renovations after the well-publicised recent construction cost increases;
    - iv. pay significant medical bills;
    - v. assist their children with buying their first homes; and
    - vi. pay for other essential expenses.

In relation to 9(a)(v) above, we note that many younger Australians are currently facing housing affordability problems arising from rising house prices, a tight rental market, and falling rates of home ownership. This problem is also a concern for many Australian parents, who worry about their children's well-being. If a parent is looking for a solution, Midkey's innovative loan product may assist them (by allowing them to unlock equity in their house, so they can help their child purchase a home).

As well as solving significant financial issues for a borrower, a Midkey loan is also structured to minimise the chance of equity erosion of a borrower's property. This is achieved by a combination of the following:

- A. charging simple interest (not compound interest);
- B. charging simple interest that is only around 1% to 2% higher than a standard mortgage;
- C. only lending as a second mortgage where the first mortgage is being amortised; and
- D. lending at conservative LVRs.

**b. Economic benefits:**

- i. We believe the Midkey loan product (and expected copycat loan providers) will change the Australian home lending market. Our innovative product will enable borrowers to access more debt in a socially friendly way via a safe equity release. This additional debt funding will provide economic benefits for the different states of Australia that Midkey operates in.
- ii. In the states of Australia where Midkey can provide loans, many Midkey borrowers will likely use their Midkey home loans to fund home renovations. This means that the Victorian SRO's Ruling will result in the residents of Victoria missing out on all the benefits that ordinarily flow from a boost to economic activity in the building and construction industry (like the creation of jobs).

This will be a significant detriment to Victorians, especially as we understand that:

- A. the building and construction industry is one of the most important sectors of the Victorian economy and has one of largest multiplier effects on the economy; and
- B. every \$1 million of residential building activity ultimately supports almost \$3 million in economic activity and sustains nine full-time jobs across the economy.

- c. **Financial competition and innovation:** there is a strong focus within the Federal regulations and government bodies to encourage financial competition in Australia. The Midkey loan is a ground-breaking product that promotes financial competition and innovation. Part 4B and the Victorian SRO's narrow interpretation of the economic entitlement provisions in Part 4B concerning Midkey has resulted in the restriction of innovation and competition in the financial industry because Midkey cannot offer its product in Victoria. This outcome contradicts government policy planning guidance applicable to regulators like ACCC and ASIC. Some examples of this guidance appear below:

- i. although the ACCC does not yet have jurisdiction over other government regulators, the Australian Government Productivity Commission Report on 29 June 2018 (<https://www.pc.gov.au/inquiries/completed/financial-system/report>) states, "... the ACCC should be given a mandate by the

*Australian Government to champion competition in the financial system, including in decisions taken by regulators that have or may have the outcome of restricting competition.";* and

- ii. ASIC's "Review of reverse mortgage lending in Australia", dated August 2018 (<https://download.asic.gov.au/media/4851420/rep-586-published-28-august-2018.pdf>) states, "*The reverse mortgage market is highly concentrated with high barriers to entry for lenders and high switching costs for consumers, all of which are likely to affect competition and lead to poorer consumer outcomes*" and "*Effective competition in the financial system should drive innovation in product offerings, improvements in product quality and variety, greater efficiency, and lower prices for the benefit of consumers.*"

- e. **Waitlist of Victorian borrowers:** Midkey currently has a waitlist of Victorian borrowers who wish to benefit from a Midkey loan. For example, Midkey has received a request for a loan from a Melbourne applicant whose principal residence is a Melbourne house worth \$4m. This applicant has three children and needs \$200,000 to cover school fees over the next few years. Their mortgage broker has indicated that the family's net income is insufficient to increase their current \$2.2m first mortgage.

The Victorian SRO's Ruling has resulted in Midkey being unable to assist Victorian borrowers. This has resulted in an inequitable outcome for Victorians, who, as a direct result, have fewer financing options than borrowers in all other states – and at a time when they are already tackling difficult economic conditions with rising interest rates and increasing inflation.

10. In addition to the above, it is important to mention that some information was unavailable to the Victorian SRO when it made its ruling. The unavailable information is below in paragraphs 10(a) to 10 (c). We believe that the Committee should consider the information below when it reviews Part 4B and the Victorian SRO's Ruling:

- a. Midkey's home loan website was not launched until April 2023, so the Victorian SRO was not able to view that website to determine that Midkey is engaged in a full-time capacity as a financier/lender;
- b. ASIC's classification of the Midkey loan as being a reverse mortgage occurred in December 2022 (approximately three months after the Victorian SRO's Ruling); and
- c. New SRO guidance on economic entitlements was published in September 2022 (<https://www.sro.vic.gov.au/economic-entitlements>) ("**New SRO Guidance**"). This guidance was not available to Midkey when it made its Submission to the SRO in May 2022.

The New SRO Guidance makes it clear that the primary purpose of the economic entitlement provisions is to reduce the avoidance of stamp duties in development projects. This is indicated by the numerous references to "developments" throughout the New SRO Guidance. In addition, the second paragraph of the guidance states, "*The amendments address the Supreme Court's decision in BPG*

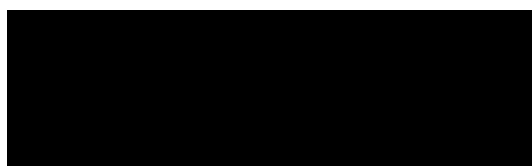
*Caulfield Village Pty Ltd v Commissioner of State Revenue [2016] VSC 172 (22 April 2016)*" (which, notably, was a case involving a development project).

As mentioned above, Midkey does not finance development projects. A Midkey loan must be secured by a completed residence. From a plain reading of the New SRO Guidance, it seems apparent that the economic entitlement provisions were not intended to impose stamp duty on a financier, like Midkey, who will not finance any developments.

### **Next steps**

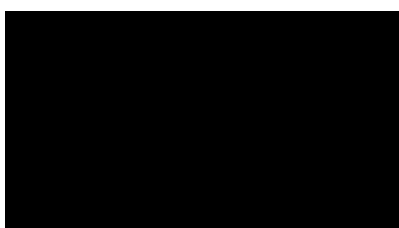
11. As mentioned in paragraph 8 above, we encourage the Committee to explore urgent reforms to Part 4B (and the SRO guidance provided for Part 4B), review the Victorian SRO's Ruling (and, in particular, the Victorian SRO's narrow interpretation of the economic entitlement provisions) and take steps to address the many negative consequences that the Victorian SRO's Ruling will cause for Victorian residents.
12. We ask that the Committee take the above steps so that the people of Victoria can have the same home loan options (and consequential opportunities and benefits) as the residents of all other states of Australia.

If you would like any additional information or if you would like to discuss any of the matters raised in this Submission, please contact us at [info@midkey.com.au](mailto:info@midkey.com.au).



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