

**Patience rewarded in home stretch**  
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Rismark's new residential trust is expected to deliver strong returns - eventually, writes Simon Hoyle.

IN ALL of the hoopla surrounding the launch of Australia's first equity finance mortgage recently, it's easy to overlook an equally important investment opportunity emerging alongside.

Rismark International, the company pioneering the EFM, has teamed up with Adelaide Bank to market the new EFM, which is designed to make the purchase of a home cheaper for borrowers.

In return for paying no interest, the borrower agrees to forgo a portion of the capital gain they make when they sell the property sometime in the future.

However, for every dollar that someone wants to borrow, Rismark has to find a dollar to lend to them. That's where the second thread of the story comes in: Rismark is poised to launch a new unit trust, the Rismark Active Property Trust (RAPT), which will give investors the opportunity to invest in residential property in a way that, until now, simply hasn't been possible. Money invested in the RAPT will be loaned to EFM borrowers.

The arrival of the EFM will therefore benefit those who want to own their own home, and the RAPT those who want to invest in residential property.

Rismark's head of capital markets, John Powell, says the company is "still working through exactly what [the trust] is going to look like".

"We have a subsidiary called Rismark International Funds Management, which is a responsible entity, so it's a unit trust," Powell says.

"Investors will ... buy units in the trust, just like buying units in an equity trust. It's no different in that respect to investing in, say, Perpetual's Industrial Share Fund.

"And the returns will be linked to the future capital values of the [residential] properties."

Under an EFM contract, a borrower does not make regular interest payments - they make no interest payments or capital repayments at all, in fact - and may not sell their home for many years after borrowing the money. That means the EFM issuer - that is, investors in the RAPT - will have to wait, possibly for several years, before returns begin to flow through.

This likely pattern of returns means the trust will undoubtedly be best suited to investors with a long-term investment horizon - most likely superannuation funds, self-managed super funds and individuals who don't need a fast return on capital.

It also means Rismark has to grapple with the issue of liquidity - that is, how to give money back to investors who want to redeem their investments before money starts flowing back into the trust.

Powell says the manager has several options. It could borrow, and use debt to meet redemptions. But Powell says debt has to be used very carefully, and can't be relied upon as the sole - or even the major - source of liquidity.

Another option might be to list the trust on the Australian Stock Exchange, so units in the trust are traded between buyers and sellers in the same way that shares are traded. The income returns that flow to unit holders would still mirror the performance of the trust's underlying property portfolio.

Yet another solution could be to hold liquid securities - cash or listed property trusts, say - to provide a "buffer". But Powell says investors in residential real estate want their money to be invested in precisely that, and a cash or other liquidity buffer may change the nature of the trust's returns.

Or finally, the manager could impose restrictions on when and how investors can redeem funds.

While no final decision has been made, it appears most likely the RAPT will be listed on the ASX. That way, its portfolio can be close to 100 per cent invested in EFMs, the trust itself won't be required to meet redemption requests, and debt can be used primarily to enhance returns. "Residential property has historically performed very, very well, and that's why we think that self-managed super funds, where cash flow isn't so important - particularly for people in the accumulation stage - will see it's a very, very solid asset class," Powell says.

Powell says potential investors need to weigh up the comparative advantages of investing directly in residential property and investing via the RAPT.

Not surprisingly, Powell believes the RAPT has the edge. Investors get exposure to a diversified portfolio of residential properties and do not have to meet any of the costs that go along with direct property investment (rates, repairs, land tax, etc). Investors in the trust will, however, pay fees to its manager.

One issue that investors will have to pay close attention to is tax. If you buy a home, and it's your principal place of residence, then generally you can sell it without paying capital gains tax. If you buy an investment property, you have to pay tax on the rental income and, if you hold the property for more than 12 months, capital gains tax on 50 per cent of any realised capital gain.

If you invest in the RAPT, it's expected the return that flows back to you will be treated as income, and you'll have to pay tax on the income.

Powell says it's absolutely imperative that potential investors seek expert financial planning or accounting advice before deciding which route to take. But even before they consult an expert, it's worth

looking at a website set up by Rismark to explain how EFMs work:  
[www.efm.info](http://www.efm.info).

The head of Mercer Investment Consulting, Tony Cole, says he expects investment in EFMs to be attractive to institutional investors, including major superannuation funds.

In a recently published research note, Cole says equity mortgages give investors exposure to an asset class that has been difficult for them to access in the past.

He says the returns from residential property are expected to remain strong, notwithstanding recent strong performances, due to basic supply and demand imbalances. But additionally, investment in residential real estate can reduce the overall risk - or volatility of returns - in an investor's portfolio.

"Historically, residential real estate displayed a negative correlation with commercial property markets and a low correlation with the sharemarket, therefore providing diversification benefits in a multi-asset class portfolio," Cole says.

Since the Herald first reported on the development of the EFM, back in November 2005, readers could be forgiven for wondering where the product had gone. Rismark's managing director, Christopher Joye, says much of that time has been spent thrashing out details with the Australian Securities and Investments Commission, the Australian Competition and Consumer Commission the Australian Taxation Office and various state fair trading departments.

But the upside, Joye says, is a product that has a good level of regulatory integrity and which can be distributed easily through traditional mortgage channels. For starters, that means Adelaide Bank, but within six months Wizard Home Loans is expected to also market the EFM, and ING Direct is expected to follow Wizard.

Even so, says Cole, investors need to recognise the risks inherent in these products.

"Risks associated with equity mortgage portfolios should be assessed on a case by case basis as the terms of the mortgage and the business model of the mortgage provider can vary markedly," he says.

"As all of these risks can be considered and assessed, with most able to be controlled to some degree, we conclude that the investment sector remains appealing for investors who can understand and accept the associated risks and benefits."

A Mercer review of the equity mortgage sector identified numerous risks, including "residential market, business start-up, initial funding, consumer demand, modelling, securitisation, business partner, origination, institutional funding, key staff, mortgage broker, economic environment, [the impact of] global warming [on] coastal locations [and] competitor risk".

"Investors who understand and accept the risks and benefits of equity mortgages may consider them, in light of their own circumstances, as a means of further diversifying property exposure."

