

SUBMISSION

Submission to Treasury —
Treasury Laws
Amendment Bill 2024:
Build to rent
developments.

22 April 2024

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22 April 2024

Dear Sir/Madam

Build to Rent developments

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the Treasury consultation on Treasury Laws Amendment Bill 2024: Build to rent developments.

About ASFA

ASFA has been operating since 1962 as the peak policy, research and advocacy body for Australia's superannuation industry. ASFA represents the APRA regulated superannuation industry with over 100 organisations as members from corporate, industry, retail and public sector funds, and service providers.

We develop policy positions through collaboration with our diverse membership base and use our deep technical expertise and research capabilities to assist in advancing outcomes for Australians.

If you have any queries or comments in relation to the content of our submission, please contact Mary Delahunty, by email mdelahunty@superannuation.asn.au.

Yours sincerely

Mary Delahunty
Chief Executive Officer

Summary comments

ASFA welcomes the opportunity to comment on the exposure draft legislation to encourage investment and construction in the build to rent (BTR) sector.

ASFA supports the objective of encouraging institutional investment into housing and affordable housing. We recognise the potential of the BTR sector to contribute positively to the housing needs of Australians and yield appropriate risk adjusted returns.

We note the under supply of housing generally in Australia which has an impact on affordability through a lack of supply. Encouraging capital flow more broadly into housing is an important component of addressing an undersupply of housing.

Superannuation investors have a responsibility to pursue appropriate risk adjusted returns for members, any encouragement of investment activity needs to be mindful that opportunities must meet this threshold.

The draft Bills represent a welcome step forward and an improvement to the current tax treatment settings of BTR which can be a deterrent for investment.

Our submission focuses on changes to the draft Bills that would encourage the participation of institutional capital at scale to meaningfully enhance the supply of housing and the supply of sustainable and affordable housing options.

Recommendations

1. The MIT withholding rate should also apply to the distribution of capital gains
2. The Australian government should consult with the States and local government on a nationally consistent definition for the term 'affordable'
3. Provide clarity on the baseline of 'market rents'. We recommend that the test be the rents charged for equivalent housing units in the development that are subject to non-concessional rents.
4. Retain the originally announced hold period of 10 years
5. Consider the GST treatment of construction costs. ASFA recommends that the GST treatment of BTR residential properties be raised with the States
6. Consider the 'key worker' cohort. It is recommended that the Bills make provision for the making of regulations that would allow for key workers to be included as part of the target market for affordable housing.

Background

An underutilised asset class

The BTR sector presents a promising market opportunity, propelled by the escalating challenge of housing affordability for low- to moderate-income households.

As an emerging asset class, BTR is witnessing significant growth in Australia, with plans to construct over 7,400 units supported by institutional capital within the next three years.

Compared to other countries, investment in Australian BTR comprises a modest fraction—less than 1% of institutional real estate portfolios—while in the United States, it exceeds 20%.

In Australia, the development of new housing has traditionally been funded mainly by the private sector, with limited contributions in recent decades from public financing for public and community housing. This has limited the development of affordable housing options.

However, BTR investments focusing on rental housing for very low to moderate income households, including key workers, can offer sustainable investment returns (provided tax and other settings are appropriate) due to several factors:

- A broader tenant base enhances demand, thereby reducing vacancy rates.
- Reduced tenant turnover results in more consistent income and stable occupancy rates.
- Lower lifecycle building costs provide a more predictable cost base.

Policy frameworks are critical in drawing institutional investment into the BTR market.

Effective government funding and supportive policy and tax measures are essential to stabilise and grow housing solutions focused on low-to-moderate income groups, ensuring that the BTR sector can contribute effectively to addressing Australia's housing affordability crisis.

ASFA supports measures that help to provide institutional investors with settings that contribute to appropriate risk adjusted returns in their portfolios.

Draft Bills

Capital works rate of deduction

The draft bills seek to provide incentives for certain BTR developments through an increase in the capital works rate of deduction from 2.5% to 4% for active BTR developments.

ASFA is supportive of this measure. However, we note the compliance requirements of this, and other measures could continue to be a deterrent for institutional investors as discussed below. Changes to the provisions in the draft Bills would lead to greater institutional investment in BTR.

Withholding tax rate

The draft bills propose a reduction in the withholding tax rate on distributions from Managed Investment Trusts (MITs) involved in BTR projects to 15% from the existing rate of 30% (Federal Government Consultation Paper on Build to Rent Housing, 2023).

ASFA supports this proposal as it will increase the sector's attractiveness to foreign investors. This reduction in tax burden better enables the inflow of international capital which will be helpful for funding the substantial development costs associated with large-scale BTR projects. We submit that the requirements to qualify for the concessional rate, being the same as the capital works deduction, could be improved as discussed below.

As noted in the Explanatory Memorandums, reducing the withholding tax rate facilitates a more competitive international investment environment, crucial for leveraging global capital markets to address Australia's housing challenges.

However, clarity is sought on the application of the concessional MIT withholding rate as it appears to apply solely to net rental income from active Build-to-Rent (BTR) developments, excluding capital gains from

property sales. Capital will be an important part of the return on the investment. Managed Investments Trusts (MITs) will generally hold a number of qualifying properties and the sale of one of them, particularly after the minimum holding period, should not lead to part of the payment to unit holders being subject to withholding tax at a higher rate. The draft explanatory memorandum omits a rationale for this limitation, which may serve to undermine the policy's objectives.

Qualifying dwellings

The draft Bills set out that dwellings must meet certain criteria to be considered as an active BTR development.

- The BTR development must consist of at least 50 dwellings that are made available for rent to the public. If the dwellings are temporarily not available for rent because of the construction of an extension, alteration, improvement, or repairs, the dwellings should still be deemed to be available for rent. Furthermore, repurposed or build to sell developments converted to BTR are also intended to qualify.
- Dwellings in the BTR development must be available to the public to be tenanted by way of lease for a period of at least three years. (some carve-outs apply).
- All dwellings and common areas for the dwellings in the BTR development must be owned by a single entity (which can include a group of owners that invest via a single entity or a new single entity owner).
- At least 10% of the dwellings must be offered as affordable dwellings throughout the 15-year BTR compliance period. Dwellings will be considered affordable dwellings if:
 - The dwellings are made available for rent, or rented, at 74.9% or less of comparable market rents; and
 - Requirements set out by the minister through a legislative instrument relating to the income of the tenant or prospective tenant are met.
- An owner of a BTR development will be required to collect information from tenants to confirm initial and ongoing tenant eligibility and submit this information to the Australian Taxation Office (ATO).
- The owner of the BTR development must make at least one of each apartment or dwelling type (i.e., a dwelling of comparable size and amenities) available as an affordable dwelling.

The “BTR compliance period” for a dwelling of an active BTR development is proposed to be 15 years beginning on:

- The day on which the development commenced being an active BTR development; or
- If a dwelling was incorporated into an active BTR development through expansion, the date on which the dwelling was incorporated into the development through expansion.

The BTR development misuse tax is proposed if a BTR development no longer meets these requirements and therefore no longer qualifies as an active BTR development at any time during the 15-year compliance period.

Dwelling classification

ASFA supports the need for incentives to be targeted to outcomes. This targeted approach will begin to rebalance the current high private investment interest in the housing market which has not delivered outcomes for those who need it most.

Experience in the US market would suggest that to catalyse a strong build-to-rent marketplace, governments need to be specific about their social outcome requirements and target incentives towards those outcome requirements. In the United States, low to moderate income housing has emerged as one of the BTR asset class's largest market segment due to tax concessions such as the Low-Income Housing Tax Credit (LIHTC) program LIHTC and concessional financing through Fannie Mae and Freddie Mac.

We note that there remains an inconsistent approach and no standard definition of "affordable" at a State or local government level.

There also is no detail about how the developer might arrive at the required baseline of "market rents" for the purposes of setting the affordable component at 74.9% of this figure. We recommend that the test be the rents charged for equivalent housing units in the development that are subject to non-concessional rents.

Minimum threshold

As discussed above, setting a minimum threshold for the number of dwellings held helps to target the incentives towards outcomes.

It should be noted that the mix of dwelling types and the thresholds of these types materially impacts the investment viability for institutions.

Further conversations with investors about how these elements are considered in financial modelling would be welcome.

Hold period

The draft bills propose a compliance period of 15 years. Ownership changes are allowed so long as the ownership structure still meets the criteria.

While ASFA acknowledges the intent behind extending the ownership retention period for BTR projects from 10 to 15 years, we do not support this proposal.

A longer retention period imposes additional risks and reduced flexibility in fund management, potentially making BTR less appealing compared to other investment opportunities.

The original 10 year proposal increases available capital and encourages recycling of capital so that new stock is created and made available in the housing market. CAPEX requirements after 10 years begin to diminish project returns making the asset less attractive.

The original 10-year period strikes a better balance between ensuring long-term commitment to the housing market and providing investment flexibility.

Therefore, we strongly advocate for maintaining the 10-year ownership retention requirement as announced in the Budget.

Further initiatives to encourage BTR investment

GST treatment

The draft bills do not amend the current GST treatment on construction costs and the non-availability of input credits to institutional purchasers.

ASFA notes that many industry participants have advocated for a consideration of a different GST treatment for dwellings that meet a certain criterion to be able to deliver affordable housing.

It is considered a different approach to that currently in place could significantly positively alter the risk return profile for investment opportunities and help with the flow of capital. The introduction of input tax credits for the costs of construction is likely to incentivise more supply of affordable housing.

ASFA recommends that the GST treatment of BTR residential properties be raised with the States.

Key workers

ASFA understands that the development of public policy requires choices to be made about the approach taken and the cohorts to be targeted.

The drafts Bills propose to use income as a method to determine eligibility for dwellings. Another metric available is 'key worker'.

While there will often be an overlap between a lower income earner and a lack of access to well-appointed housing, this is not the case for every region. ASFA would welcome the opportunity for our members, many of whom have sizable exposure relative to the market in BTR, to discuss the key worker cohort with the Government.

It is recommended that the Bills make provision for the making of regulations that would allow for key workers to be included as part of the target market for affordable housing.