



SUBMISSION

Submission to Senate
Economics Committee —
Treasury Laws
Amendment Bill 2024:
Build to rent
developments

25 June 2024

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Senate Standing Committee on Economics

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Parliament House

CANBERRA ACT 2600

Via email: economics.sen@aph.gov.au

25 June 2024

Dear Sir/Madam


Build to Rent tax concessions

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in regard to the inquiry of the Committee in regard to the Treasury Laws Amendment (Responsible Buy Now Pay Later and Other Measures) Bill 2024 [Provisions] and Capital Works (Build to Rent Misuse Tax) Bill 2024 [Provisions], specifically in regard to the build to rent provisions.

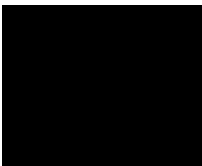
About ASFA

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 Ross Clare, by email .

Yours sincerely



James Koval
Head of Policy and Advocacy

Summary comments

ASFA welcomes the opportunity to comment on the provisions of the Bills which are intended to encourage investment and construction in the build to rent (BTR) sector.

ASFA supports the objective of encouraging institutional investment into housing, including 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 undersupply of housing generally in Australia which has an impact on affordability through the price impacts of 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 an improvement to the current tax treatment settings of BTR which can be a deterrent for investment. These proposed settings will have their primary impact on overseas based investors, with a very small impact on local investors given that the main tax change relates to a reduction in the withholding tax rate that applies to eligible investments. That withholding tax is not relevant to Australian domiciled investors, including superannuation funds.

It also should be noted that as currently drafted the tax concessions proposed will have only a very modest impact on the Budget, \$10 million in 2025-26 and \$20 million in 2026-27. Given the scope of unmet demand for affordable rental housing an expansion of the tax concessions would be appropriate.

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

Recommendations

1. The Australian government should consult with the States and local government on a nationally consistent definition for the term 'affordable'
2. 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.
3. Apply a hold period of 10 years rather than 15 years
4. Consider the GST treatment of construction costs. ASFA recommends that the GST treatment of BTR residential properties be raised with the States
5. Consider the 'key worker' cohort. It is recommended that the Bills make provision for the making of legislative instruments 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.

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.

There also is a case for tax and policy settings to be supportive more generally for BTR developments rather than requiring every supported BTR development to have an affordable housing component. Institutional ownership of rental accommodation can provide greater security of tenure for renters and this should be made available for renters generally.

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

The Bills

Capital works rate of deduction

The 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.

However, for domestic investors this only leads to a very marginal change in investment returns. Material in the Explanatory Memorandum indicates that the incentives are focussed on overseas based investors with little or no impact on domestic investors in the early years. The main benefits seen for domestic investors are a demonstration effect and the build up of a stock of institutionally owned residential property in Australia.

While ASFA is not opposed to this measure, we note the compliance requirements of this measure could continue to be a deterrent for institutional investors as discussed below. Changes to the provisions in the Bills increasing the scope of the tax concession for domestic institutional investors would lead to greater investment in BTR.

Withholding tax rate

The 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.

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 access to affordable housing 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. Rather than relying on general principles of taxation law we recommend that the test be the rents charged for equivalent housing units in the development that are subject to non-concessional rents.

Hold period

The 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 the originally mentioned at least 10 years 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.

Adoption of the original at least 10 year proposal would increase available capital and encourage 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.

Further initiatives to encourage BTR investment

GST treatment

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

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