



79 Constitution Avenue
Canberra ACT 2612
t (02) 6245 1300
f (02) 6257 5658
hia.com.au

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Senate Economics Legislation Committee

By website: www.aph.gov.au/senate/economics

Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2018

The Senate has referred the following legislation to the Senate Economics Committee for inquiry and report:

- Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018;
- Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2018; and
- Income Tax Rates Amendment (Sovereign Entities) Bill 2018.

HIA's interest in these Bills relates to the Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2018, as it relates to investment in housing.

MIT Residential Housing Income

In the 2017-18 Budget, the Government announced a package of measures designed to improve outcomes across the housing sector.

Several of these measures specifically address housing affordability for members of the community earning low to moderate incomes by providing incentives for investors to increase the supply of affordable housing.

In the 2017-18 Budget package, the Government announced that MITs would be prevented from investing in residential premises unless they are commercial residential premises or affordable housing.

The legislation being considered by this Committee is distinctly different from that announced in the 2017-18 Budget. This legislation allows MITs to invest in residential housing that is held primarily for the purpose of deriving rent. However, distributions that are attributable to investments in residential housing that are not used to provide affordable housing will be non-concessional MIT income that is subject to a final MIT withholding tax at a rate of 30 per cent.

Overview

As the mining boom receded from 2012 onwards, a boom in the housing industry drove the Australian economy to achieve 28 years of continuous growth.

Housing is also of significant importance to individual Australians as it is the largest financial decision most Australians make and also a major store of wealth.

The housing industry is heavily influenced by government policy at a federal, state and local level. All three tiers of government impose taxes and regulations constraining the industry. Around one in every ten dollars of taxation imposed in the economy is a tax on housing.

With the tax burden on a new house and land package exceeding 40% of the purchase price and the Reserve Bank of Australia estimating that the administrative burden is adding \$390,000 to the cost of an average apartment in Sydney it is clear that the affordability challenge has been greatly exacerbated by Government interventions into the housing market.

Governments at all levels, have been very active in adjusting policy tools that impact on the housing market.

The government should be mindful that if it intends to distort the housing market by investing resources into 'Build to Rent' projects for the provision of 'for profit' rental accommodation, then this is acceptance that the goal of home ownership has been lost in Australia.

HIA remains focused on home ownership as a goal for all Australians.

Given the importance of housing to the economy, the wealth of individuals and the complexity of the regulatory arrangements, any changes that impact on the housing industry should be carefully considered. The housing market is also the subject of significant changes in policy and taxation arrangements that are impacting the market.

In regards to the Bills before this Committee, HIA is interested in the consideration of initiatives within the Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2018 which are aimed at facilitating "Built to Rent" in Australia.

To the extent that the arrangements outlined in this Bill do not provide a financial incentive or distort tax neutrality in the housing investment market then we do not oppose the passage of these measures.

If the government does intend to provide financial incentives to encourage Built to Rent - 'for profit' accommodation then it should undertake a detailed analysis of the impact of this change on the factors listed in this submission.

Policy Consistency

In making changes to tax arrangements applicable to Managed Investment Trusts (MIT's) the government should be mindful of the consistency of these changes with other regulatory imposts.

Investors are an important component of the housing market as they account for at least one third of the market for new homes which is necessary to meet the growing demand for rental accommodation. Investors are vital to ensuring an adequate supply of housing.

Over recent years the Australian Government, with the assistance of state governments, have intervened in the housing market to force investors out of the Australian housing market.

Government and regulatory initiatives adopted in recent years to force investors out of the housing market include:

1. APRA's increased regulatory measures

This sequence of restrictions date back to 2014 when APRA instructed banks to limit their growth in lending to investors to 10 per cent per annum. The regulator took another step in 2017, instructing banks to limit their issuing of interest-only loans to 30 per cent of new loans. These were APRA's headline regulatory measures and banks responded in varying ways but ultimately by tightening their lending standards – whether this be through increased deposit requirements, tougher serviceability checks or higher interest rate buffer tests. In more recent months, the Banking Royal Commission and falling house prices have reaffirmed banks' flight to quality given the even greater scrutiny that bank practices now face.

2. State taxes and policies

State taxes and policies regarding the housing market have had two particular targets in recent years – foreign investors and first home buyers. In relation to foreign investors, states have introduced additional charges to foreign investors in the housing market. Victoria was the first mover in 2015, and now in 2018, all

jurisdictions except for the Northern Territory impose some form of additional charge on foreign investors in the housing markets.

The new frontier of additional taxes on investors in the housing market relates to vacant properties. The Federal government, along with the Victorian government, have imposed these additional taxes on owners of vacant residential properties. The federal tax applies only to foreign owners, while the Victorian tax applies to owners of properties in specific suburbs. These taxes have just started to take effect this year.

In contrast, first home buyers are enjoying a new wave of benefits and incentives for them to enter the market. At a minimum, first home buyers around the country are generally eligible for at least stamp duty concessions. The most lucrative incentive scheme is in the Northern Territory, where first home buyers seeking to buy or build a new home can be eligible for a handsome \$26,000.

In addition there are international factors weighing on investor participation in the domestic housing market:

- a) capital controls on outflows of funds from China, and;
- b) the process of interest rate hikes among the advanced economies.

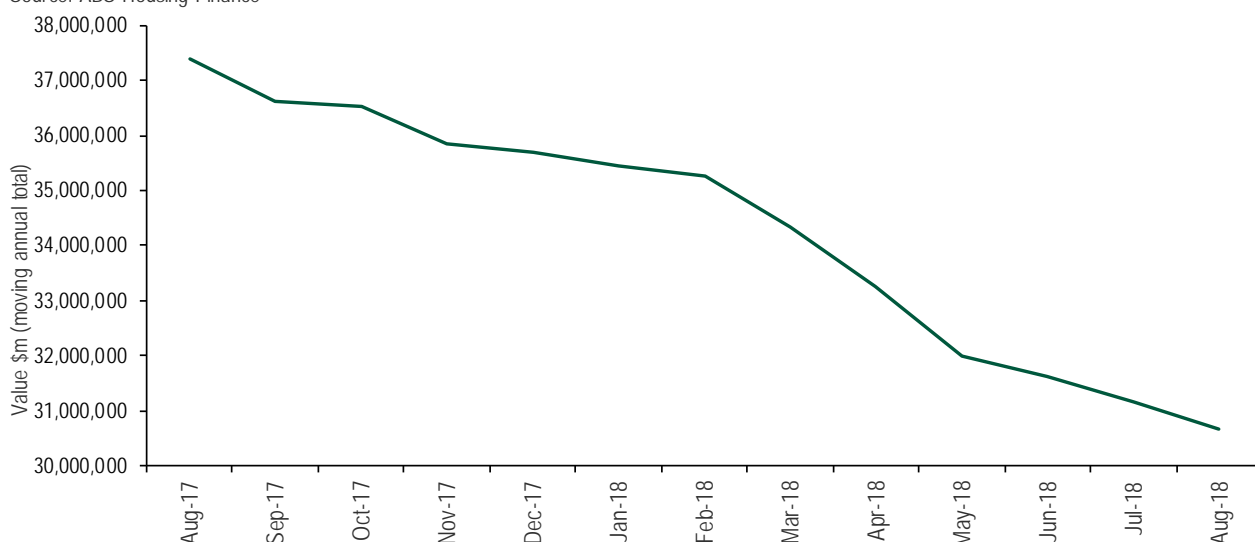
Two years ago, when fears were especially acute relating to China's economic and financial stability, capital outflows were thick and fast. The Chinese government ratcheted up capital controls to stem the flow. Only now is there some sentiment that these controls could be relaxed.

Finally, the process of interest rates starting to rise in other advanced economies. The US Federal Reserve was the first of the major economies to start hiking rates – this happened back in 2015, but the subsequent moves were somewhat slow to follow. Critically, the official cash rate in the US overtook Australia's in March this year, when it was lifted to 1.75 per cent. Still in North America, Canada's official cash rate started rising in July 2017. Across the Atlantic, the Bank of England began hiking rates in back in 2016 and to date have lifted them three times. The relevance for Australia is because of Australia's relatively heavy reliance on offshore funding, these overseas rate hikes will eventually result in higher domestic borrowing costs faced by Australian borrowers.

As a consequence of these interventions in the housing market, investor activity has fallen by more than 20 per cent over the past year. These policy interventions are one of the factors that is causing the fall in house prices in metropolitan areas.

Lending to investors 3 month rolling total - Australia

Source: ABS Housing Finance



If the Australian government is signalling that it aims to attract foreign investment into the Australian housing market, through reducing the barriers to investment through MIT's, then it should do so by removing the restrictions, as listed above, which impede investor activity in the market.

Build to Rent – 'For Profit'

Compared to other countries, large scale ownership of private rental of housing has not been a major feature of the Australian market. Private rental ownership has primarily been the realm of 'mum and dad' investors who supply scattered housing across Australia at the market rate.

Build to Rent refers to developments specifically designed and built for longer term renters, whether in the private market or the subsidised rental market. The developer or major investor, who may be a community housing provider, maintains ownership of all the properties rather than selling them to individual buyers.

Build to Rent properties are not sold to individual owners or investors after the development is complete. Rather, developers or groups of investors with interests in the building maintain an ongoing interest in the property and later manage the rental of the residences themselves.

The aim of the Build to Rent system is to provide a more secure tenure option for those in the rental market through offering longer-term leases. Also attractive to prospective tenants is the offer of centralised building maintenance services onsite (rather than having to call the real estate or landlord), and potentially greater flexibility for tenants to redecorate and feel more at home. In some cases, more affordable options are also on offer.

Build to Rent developments are commonplace in the EU and are increasing in popularity in the UK and parts of the USA.

In recent years, there has been speculation that such schemes will also be established in Australia for the provision of 'for-profit' Build to Rent schemes.

There appears to be a role for 'Built to Rent – for profit' schemes to be delivered in the Australian market.

In encouraging Built to Rent schemes in Australia, the government should consider the impact of such schemes on:

- Existing investors in the housing industry, principally individuals, who use investments in housing as a store of wealth.
- The impact on the changing incentives of home tenure away from ownership to long-term rentals on wealth generation.
- The impact of providing financial incentives on the type of dwellings made available.

The government should also be mindful that if it intends to invest resources into incentivising commercial 'Build to Rent' for the provision of 'for profit' rental accommodation through the provision on incentives such as tax concessions, then this is acceptance that the goal of home ownership has been further eroded in Australia.

HIA remains focused on home ownership as a goal for all Australians.

The deterioration in the affordability of housing has been exacerbated by government impost's on the market and removing these imposts would be the best and most effective way to alleviate the problem. To this end, we advocate in favour of policies and incentives designed to assist home ownership as the priority for government expenditure.

To the extent that, the arrangements outlined in this Bill do not provide a financial incentive or distort tax neutrality in the housing investment market, we are not concerned with these aspects of the Bill.

If the government does intend to provide financial incentives to encourage 'for profit' – Built to Rent accommodation then it should undertake a detailed analysis of the impact of this change on the factors listed above.

Affordable Housing

In the 2017-18 Federal budget the Treasurer announced the creation of the National Housing Finance and Investment Corporation (NHFIC).

The creation of the NHFIC is intended to recognise that community housing providers in Australia are filling the void left by reduced public housing expenditure. These housing providers supply a large proportion of private rental properties to tenants that receive commonwealth or state rental housing assistance, along with managing public housing properties on behalf of state governments.

Prior to the federal budget the NHFIC was referred to as the 'bond aggregator'. The Government has committed an initial \$9.6 million in 2017-18 to establish the NHFIC, which will commence operations from 1 July 2018. Legislation to establish the Corporation and develop the initial procedural aspects is currently before federal Parliament.

The NHFIC will operate an affordable housing bond aggregator to provide cheaper and longer term finance for community housing providers by aggregating their borrowing requirements and issuing bonds into the wholesale market at a lower cost and longer-term than traditional bank finance.

As recognised in the private market version of build to rent, achieving an adequate return on investment for community housing providers is a challenge.

HIA supports appropriate tax incentives to support community housing 'Build to Rent' schemes and measures in this Bill appear to support this goal.

Conclusion

HIA welcomes the opportunity to comment on these Bills.

We are concerned that this Bill seeks to reduce the barriers to investors, particularly foreign investors engaging in the Australian housing market, at the same time as the Australian and state governments are imposing a range of punitive restrictions on these same investors. This could be addressed, in part, by removing the restrictions on investor activity in the market.

Secondly, HIA recommends that the government carefully consider the wider implications of incentivising Build to Rent –For Profit initiatives before providing financial incentives. This matter goes beyond the elements contained in this Bill.