



**Submission to: Senate Economic Legislation Committee
Treasury Laws Amendment (Responsible Buy Now Pay Later and
Other Measures) Bill 2024 – Build to Rent matters**

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Submission summary

The government proposes to equalise Withholding Tax treatment of Build to Rent (BTR) housing with that for other asset classes, and to bring the depreciation treatment of BTR developments into line with that for serviced apartments. Both of these changes are reasonable and deserve support in the interests of accelerating the expansion of a housing typology with the potential to fulfil several important housing policy objectives, as listed in Section 1 of this submission.

The proposal that BTR project eligibility for the new tax arrangements will depend on the inclusion of affordable housing units is also a laudable bid to satisfy another policy objective. The precise nature of the proposed affordable housing requirement is, however, problematic. With rents for 'affordable' units set at 74.9% of the market rate, as proposed, these will be beyond the reach of even median income households. Moreover, even this very modestly 'affordable' status will expire after 15 years. Even within this limited period, therefore, the measures will make little or no contribution to easing unmet housing need experienced by low income Australians.

It is therefore recommended that the legislation is further amended as follows:

1. Revise the prescribed rent-setting formula for designated 'affordable tenancies' to target low income workers – i.e. households in quintile 2 of the income distribution; rents might thus typically equate to around 50-60% of market rent, not 74.9%
2. Consider increasing the size of the Withholding Tax concession allowable for qualifying developments, consistent with the requirement for 'affordable' tenancy rents more markedly discounted than proposed in the draft legislation
3. Require that affordable tenancies are managed by registered community housing providers
4. Obligate the government of the day to review the functioning of the reformed Withholding Tax framework for BTR after five years to inform decisions on its continuation.

More broadly, it seems illogical that a policy seeking to generate (sub-market) affordable housing provision in the course of market housing development is restricted to only a very small niche within overall residential development industry output. Under the current proposals it would apply to neither domestically-funded BTR projects, nor – far more importantly – to build to sell projects. This seems particularly incongruous when the targeted niche, BTR, is an industry product already placed at a competitive disadvantage to other forms of residential development by property tax settings that are not currently proposed for reform (negative gearing, Capital Gains Tax discount, GST).

A more logical approach in attempting to secure a small contribution of sub-market affordable rental housing as a routine spin-off from new market housing development would be to:

- Encourage and incentivise state governments to expand the scope of such a policy to all new BTS as well as BTR housebuilding projects above a given threshold size – other than in areas with low land value
- Rely on policy implementation via landuse planning systems rather than via the Federal tax system, through arrangements where development approval is conditional on pledged affordable housing contributions (sometimes termed 'mandatory inclusionary zoning').

All of this highlights the unsatisfactory nature of progressing housing reform in an unco-ordinated piecemeal manner, an approach certain to further add to regulatory complexity and cost. As already evident at the time of the 2010 Henry Tax Review, and as also exemplified in this submission, Australia's existing residential property taxation regime is riddled with illogicalities and inconsistencies. These call for a root and branch review to inform a comprehensive housing reform strategy.

1. Build to Rent housing – overview

Build to Rent is the term used in Australia to describe residential developments (usually apartment blocks) designed and constructed for long term rental use under a single owner – typically an institutional investor such as a super fund, insurance company or sovereign wealth entity. The prime business objective for BTR proponents is a secure and predictable rental income stream. This contrasts with the capital gain motivation typically uppermost for the small-scale landlords who continue to dominate Australia’s private rental market.

The BTR model that has begun to emerge in Australia in recent years is tending to target high end tenants. And while it may be expected that industry output will diversify over time, it will generate housing affordable to low/moderate income earners only if regulated and/or incentivised to do so. As argued in a recent report by the National Housing Supply and Affordability Council¹, the model nevertheless offers scope to fulfil several other housing policy objectives:

1. Possible net addition to housing supply – conventional wisdom says this will moderate both house prices and rents over time.
2. When rental income (not capital gain) is prime landlord motivation, the product is inherently more secure tenure from tenant perspective
3. Multi-unit buildings commissioned for retention in single ownership should incentivise utility, durability and energy efficiency in design and construction
4. Professional and customer-oriented management promised by BTR is potentially beneficial for BTR tenants and perhaps beyond – as ‘positive disrupter’ for private rental housing more broadly.
5. As a new component of the rental market, BTR provision potentially broadens rental housing choice – albeit choice restricted to moderate to high income households
6. Given investor intentions for a long term hold, BTR construction demand promises to moderate housebuilding industry volatility in response to short-lived market downturns.

As far as the first of the above objectives is concerned, considering that in 2023 Australian governments jointly committed to ensuring the construction of 1.2 million dwellings in the five years from 1 July 2024, substantially expanded BTR development output during this period may be a policy imperative.

Beyond the six broader housing policy objectives potentially fulfilled by BTR, as mentioned above, there is also the hope that regulatory instruments and/or tax concessions could harness industry growth via incorporation of sub-market rental accommodation in market price BTR developments.

¹ NHSAC (2023) Barriers to Institutional Investment, Finance and Innovation in Housing
<https://nhsac.gov.au/sites/nhsac.gov.au/files/2024-02/barriers-to-institutional-investment-report.pdf>

2. Build to Rent housing in Australia

In the form of purpose-built student accommodation (PBSA), BTR has been expanding steadily in Australia since the 1990s. By 2023 it was estimated that the industry had generated 84,000 bedspaces² (over and above those provided by universities themselves). Only since the late 2010s, however, has a ‘mainstream market’ version of BTR begun to emerge in some capital cities, notably Melbourne. Some 5,000 units had been completed by 2023, with 9,000 under construction and another 24,000 in the pipeline³.

Institutionally financed purpose built rental housing is much more strongly represented in other high income countries, most notably in Canada and the United States. Its still very limited presence in Australia is partly attributable to its historically less favourable tax treatment compared with other forms of housing.

Unlike small scale private landlords, BTR investors do not benefit from standard state land tax liability thresholds and rates which are typically preferential for so-called ‘mum and dad investors’. Also, by comparison with both build to sell (BTS) and PBSA developers, BTR proponents face higher costs of provision because – unlike the former – they are exposed to GST. While PBSA is arguably a variant of BTR, such developments are treated in the tax system as ‘commercial residential’ projects – meaning that they are effectively insulated from GST on development expenditure. Beyond this, since most apartments built in contemporary Australia are purchased by small landlords, multi-unit BTS developers are also indirect beneficiaries of the negative gearing and Capital Gains Tax concessions that inflate the apartment prices that such purchasers are willing to pay.

As reported by BTR industry players, and validated by our own independent research⁴, these factors contribute to a situation in which – at least in the market conditions prevailing at the time of our study (2018) – the financial feasibility of the BTR development model remained typically marginal. This is reflected in the fact that BTR developers are usually hard pressed to outbid residential developer market rivals for suitable sites.

Beyond this, as it attempts to gain a foothold in Australia, mainstream market BTR remains an unfamiliar asset class from the perspective of domestic institutional investors. Risk aversion towards BTR investment therefore remains high. For this reason, at least until it gains scale and maturity, Australian industry growth is likely to be substantially reliant on overseas-based funders – that is, institutions already well-accustomed to the BTR product from their interest in it in North America, Europe or elsewhere.

² Savills (2023) Australian Student Accommodation 2023 <https://pdf.savills.asia/asia-pacific-research/australian-research/australia-student-accommodation/australian-student-accommodation-2023.pdf>

³ JLL (2024) Australian Apartment Market Overview Q4 2023 <https://www.jll.com.au/en/trends-and-insights/research/australian-apartment-market-overview-q4-2023>

⁴ UNSW City Futures Research Centre (2019) Build-to-rent in Australia: product feasibility and potential affordable housing contribution; Sydney: Landcom <https://apo.org.au/node/246516>

3. Managed Investment Trust tax liabilities

Managed Investment Trusts are the legal structures typically used to facilitate large-scale property investment, whether in the form of commercial, retail or – latterly – residential development. Unlike other Australian companies, which pay 30% tax on their profits, MIT investment income is assessed for tax at the level of the Trust’s unit-holders.

MITs can invest in residential property, but under current arrangements, income from ‘residential housing’ (other than affordable rental housing) is subject to a 30% withholding tax for foreign investors. Effectively, this means that overseas-based investors in BTR operations using MITs are taxed at a higher rate than domestic institutions and at a higher rate than overseas investors in other asset classes (e.g. commercial/retail property) where a 15% withholding tax rate applies.

From the industry perspective the more ‘highly taxed’ status of overseas-based BTR investors is considered both important and problematic because, for reasons explained above, overseas investors would be otherwise likely to act as prime movers in the hoped-for early expansion of an Australian BTR sector⁵.

4. Budget 2023 reform proposals to be legislated in 2024

MIT withholding tax changes initially announced in Budget 2023 have now been incorporated in a wider reform package for which Parliamentary endorsement is now sought. These proposals have been already modestly revised following Treasury consultation on a first draft version in April 2024.

Under the revised package qualifying BTR projects will be subject to:

- Capital works deduction rate increased from 2.5% to 4% - i.e. allowing expenses to be depreciated for tax over a 25-year span, rather than standard 40 years, and
- Withholding tax rate on fund payments from eligible MIT investments reduced from 30% to 15%.

Relative to standard company tax rates (see above), the proposed new withholding tax rate is considered by Treasury as ‘concessional’. From the industry perspective, however, the proposal is considered as ‘levelling the playing field’ since it also equalises tax liability on residential and commercial property income for asset-generated returns, regardless of whether the investor is a domestic or international entity. Similarly, in increasing the capital works deduction rate, the proposals bring BTR into line with the established framework for serviced apartments in this respect.

Qualification for the above arrangements is proposed as being conditional on the following:

- The development consists of 50 or more residential dwellings for rent
- The scheme is to be held as rental housing for at least 15 years

⁵ UNSW City Futures Research Centre (2019) Build-to-rent in Australia: product feasibility and potential affordable housing contribution; Sydney: Landcom <https://apo.org.au/node/246516>

- Tenancies must be of at least 3 years duration
- 10% of the dwellings are made available as affordable tenancies.

Beyond this, the affordable housing obligation is more precisely defined as follows:

- Designated affordable units must be made available for at least 15 years
- Rent must be restricted to a maximum of 74.9% of ‘comparable market rents’

Dwellings subject to ‘affordable housing’ requirements – to be rented out at sub-market prices – must be let to households fulfilling income eligibility criteria. However, under the revised reform package subject to the current consultation, these limits are not specified. Instead, the power to determine appropriate income limits is delegated to the Housing Minister by way of legislative instrument⁶. The aim will be to ensure that ‘affordable dwellings are not provided to those with adequate means to access normal market tenancies’.

5. Comments on reform proposals

Critique

For the reasons listed in Section 1, there is a valid case for Australian governments to encourage the expansion of BTR housing provision. That should include, at the very least, re-balancing of any taxation or regulatory regimes that unduly disadvantage BTR development with respect to competing forms of residential construction or in relation to other investment asset classes.

The revised proposals address a number of the concerns raised by consultees participating in the Treasury consultation on the draft Bill earlier this year.

Arguably, however, the package may still fail to fulfil the Treasurer’s Budget 2023 claim that the reforms would significantly enhance the appeal of BTR as an investment target for overseas funds. This reflects the fact that potential enhancements to financial feasibility resulting from Withholding Tax and depreciation allowance changes would be offset (or perhaps even negated) by the ‘affordable housing’ obligations that were unmentioned when the reforms were originally announced.

At the same time, although the idea of requiring sub-market housing to be included in new developments benefiting from the tax concessions appears appealing from an affordable housing advocacy perspective, the contribution of such arrangements to meeting housing need will be, in fact, minimal. Priced at the proposed level such tenancies will be beyond the reach of lower income households, as well as being set to revert to market price after 15 years. Even within this limited

⁶ Under the earlier version of the reform package it was stated explicitly that affordable units must be rented out to households defined as in receipt of low-moderate incomes. Those limits were proposed to be set at 120% of average earnings for a single person, 130% of average earnings for a couple, and 140% for a family with children. For a single person, as at November 2023, the nominal income limit would have been \$122,000 – around double the allowable limit for NRAS eligibility.

period, therefore, the measures will make little or no contribution to easing unmet housing need experienced by low income Australians⁷.

For example, advertised rents for recently completed Build to Rent scheme in Sydney and Melbourne indicate typical minimum weekly ‘market rents’ in the range \$815-\$935 for a 2-bedroom apartment (BTR provider websites). Thus, according to the 74.9% of market rate formula, the ‘affordable rent’ for such units would be in the range \$610-\$700 per week.

Using the conventional benchmark rental affordability threshold of 30% of household income, rents in this range would be beyond the means of any household receiving a gross weekly income below the range \$2,035-\$2,334. However, the estimated national median household income in Q1 2024 was only \$1,929 (2021 ABS figure⁸ up-rated according to the wage-price index⁹). Thus, the so-called affordable rent dwellings will be beyond the means of even median income households.

Possible amendments to address remaining concerns

Given the issues outlined above it is recommended that the legislation is further amended as follows:

1. Revise the prescribed affordable rent-setting formula to bring such tenancies within the means of lower income households
2. Consider increasing the size of the Withholding Tax concession allowable for qualifying developments, consistent with the requirement for ‘affordable’ tenancy rents more markedly discounted than proposed in the draft legislation
3. Require that affordable tenancies are managed by registered community housing providers
4. Obligate the government of the day to review the functioning of the reformed Withholding Tax framework for BTR after five years.

Each of these proposals is briefly elaborated below.

Affordable rent setting formula: To make a meaningful contribution to meeting housing need experienced by Australians unable to secure adequate accommodation via the market, the affordable housing units required for qualifying schemes should be targeted further down the income scale. To accommodate low income workers, rents need to be gauged with respect to affordability for income quintile 2 households. On a discount to market basis, that might typically equate to 50-60% of market rents rather than 74.9%.

Size of Withholding Tax concession: Excluding the possibility that the duration of affordability restrictions could be reduced below 15 years, each apartment designated ‘affordable’ under the affordable rent setting formula proposal above would impose a greater financial burden on development project feasibility than under the Government’s affordable rent setting proposal as currently specified. Logically, such a change would call for a ‘balancing’ amendment to the proposed

⁷ Van den Nouwelant, R. et al. (2022) Social and affordable housing: needs, costs and subsidy gaps by region <https://cityfutures.adu.unsw.edu.au/social-and-affordable-housing-needs-costs-and-subsidy-gaps-by-region/>

⁸ ABS (2023) New Census insights on income in Australia using administrative data <https://www.abs.gov.au/articles/new-census-insights-income-australia-using-administrative-data>

⁹ ABS (2024) Wage Price Index, Australia <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/wage-price-index-australia/latest-release>

rules to offset its impact on project feasibility¹⁰. This could be achieved by either reducing (from 10%) the stipulated proportion of ‘affordable tenancies’ in a development project or, preferably, by a more substantial adjustment in tax settings to the benefit of BTR developers. This could involve cutting the Withholding Tax for qualifying schemes to a concessional rate of 10% instead of 15% as currently proposed. Ideally, the detail of these proposals (affordable rent setting formula, Withholding Tax rate) would be shaped through financial modelling to be undertaken by Treasury with independent validation.

The duration of the proposed concessional arrangement could also be time limited – e.g. applicable to all schemes with construction commenced since the Budget 2023 announcement and for five years from the date of the legislation being enacted. The possible continuance of the regime beyond that point could be informed by a review to be undertaken at that point – see below.

Separate to the question of rewarding BTR operators complying with affordable housing inclusion requirements, consideration should be given to a specific Withholding Tax concession to reward highly energy efficient design and construction. Since other property asset classes can qualify for such a reduction by running a green MIT, there is case for extending such treatment to BTR buildings certified as 5 Star Green Star.

Management of affordable rental units: The legislation should also be amended to require that affordable tenancies incorporated within market BTR schemes are managed by registered community housing providers (CHPs). CHPs are appropriately qualified to allocate and manage tenancies occupied by lower income households. A major benefit of such an approach will be scope for policing compliance with affordable housing requirements via CHPs and their existing regulatory frameworks. This will obviate – or at least minimise – the need for the complex compliance and claw-back arrangements currently proposed in the Capital Works (Build to Rent Misuse Tax) Bill.

Regime review obligation: The legislation should incorporate a commitment to an independent review of the reformed Withholding Tax framework five years after enactment. This assessment would inform decisions on the possible extension of the Withholding Tax concession and/or adjustments to its terms. It could also consider the integration of affordable housing requirements for BTR schemes funded by overseas investors and imposed by the federal government under tax powers with state-administered inclusionary zoning regimes requiring affordable housing contributions from build to sell developers and implemented under landuse planning powers.

6. A wider perspective

If implemented as currently proposed, and assuming BTR projects remain viable on this basis, the new regime will gradually generate a body of shallowly affordable housing as an offshoot of market BTR projects funded by overseas investors. Fifteen years after the introduction of the new regime

¹⁰ Especially within the context of an understanding that BTR project feasibility will remain typically marginal on the basis of the Government’s proposals – i.e. the effect of Withholding Tax reduced to 15% and depreciation allowance increased to 4% will be largely offset by the requirement to provide 10% affordable tenancies rented out at 74.9% of market rate for 15 years.

the net growth of this cohort will probably begin to slow, as initially designated affordable units cease to be managed as such.

More broadly, a framework for incorporating affordable rental housing units as a small proportion of larger market housing developments is a highly attractive prospect, particularly if – as posited in land economics – the cost is borne by land value (which, being typically high in urban Australia, could realistically support this). At the same time, in the form currently proposed, the affordable tenancies that may be generated through these measures will make little or no contribution to easing unmet housing need among low income households.

Beyond this, it seems illogical that – as currently proposed – the application of such a policy is restricted to only a very small niche within overall residential development industry output. It would apply to neither domestically-funded BTR projects, nor – more importantly – to the far larger BTS development industry. This is particularly the case when the targeted niche is, as it would seem, otherwise placed at a disadvantage by other property tax settings that are not proposed for reform (particularly GST).

A more logical approach in attempting to secure sub-market affordable rental housing as a spin-off from new market housing development would be to:

- Expand the scope of such a policy to all new BTS as well as BTR housebuilding projects above a given threshold size – other than in areas with low land value
- Implement the policy via the landuse planning system rather than via the Federal tax system, through arrangements where development approval is conditional on pledged affordable housing contributions¹¹.

While such policies would need to be implemented by state/territory governments, they could be financially incentivised to do so by the Commonwealth Government along the lines of the New Home Bonus scheme.

All of this highlights the unsatisfactory nature of progressing housing reform in an unco-ordinated piecemeal manner, an approach certain to further add to regulatory complexity and cost. As already evident at the time of the 2010 Henry Tax Review, and as also exemplified in this submission, Australia's existing residential property taxation regime is riddled with illogicalities and inconsistencies. An example with direct relevance to the subject of this consultation is the fundamentally different tax treatment of PBSA and mainstream BTR development. Such discrepancies call for a root and branch review to inform a comprehensive housing reform strategy.

¹¹ Constellation Project (2023) Mandatory Inclusionary Zoning: National Framework
https://www.communityhousing.com.au/wp-content/uploads/2023/10/NHHP-Submission-MIZ-national-framework_2023.pptx.pdf?x57237