Changing tax settings affecting Build-to-Rent project viability in Australia

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Session overview

1. Housing policy objectives potentially fulfilled by BtR
2. Key BtR tax liabilities – national and state/territory tax frameworks
3. Recent developments on tax rules affecting BtR
4. Conclusions

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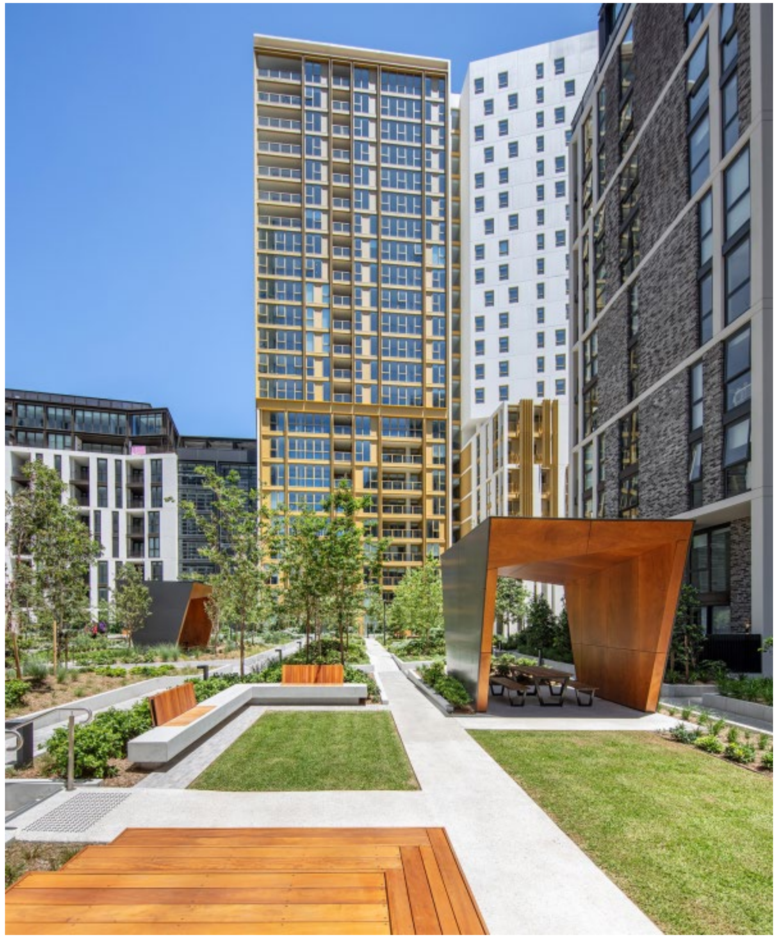
1. Housing policy objectives potentially fulfilled by BtR

The Australian BtR offer

- Target consumers are relatively 'high end' households – young professionals and affluent older second homers
- Projects strongly inspired by upmarket US 'multi-family housing' model – incorporating additional services – e.g. gyms, communal workspaces, storage facilities
- Rents well above local area median values – reflecting price (some) housing consumers willing to pay for product package:
  - Additional services
  - Substantial tenure security
  - Housing management responsiveness



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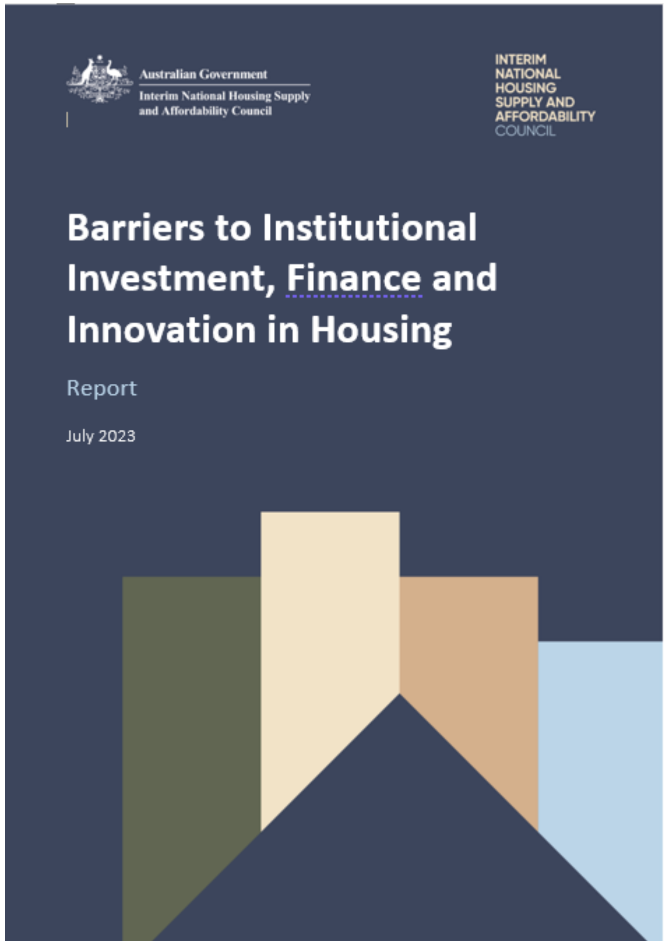
BtR relevance to housing affordability challenge

- Market-price BtR not, in itself, a solution to Australia's housing affordability challenge
- Possible diversification of BtR offer over time, as in UK
- Could be influenced by evolution of state/territory govt policy settings – later slides

Housing policy objectives potentially fulfilled by BtR

1. Possible net addition to housing supply – conventional wisdom says will moderate both house prices and rents over time
2. When rental income (not capital gain) is prime landlord motivation, result is inherently more secure tenure from tenant perspective
3. Multi-unit building commissioned for retention in single ownership should incentivise utility, durability and energy efficiency in design & construction
4. Professional management potentially beneficial for BtR tenants and perhaps beyond – as 'positive disrupter' for private rental housing more broadly.
5. New component of rental market potentially broadens rental housing choice – albeit choice restricted to moderate to high income households
6. Relatively resilient institutional investor construction demand promises to moderate housebuilding industry activity/output volatility in response to market downturns
7. If borne out, expectation of relatively rapid market absorption for BtR output could accelerate large scale urban renewal projects


Australian Government
Interim National Housing Supply and Affordability Council
INTERIM NATIONAL HOUSING SUPPLY AND AFFORDABILITY COUNCIL
Barriers to Institutional Investment, Finance and Innovation in Housing
Report
July 2023

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2. Key BtR tax liabilities – national and state tax frameworks

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Key BtR tax liabilities – Federal Govt Withholding Tax

- MITs (Aus REITs) a popular financial vehicle for BtR investment
- Tax on MIT distribution (investor returns) structured according to:
  - Asset class (e.g. commercial vs residential)
  - Investor jurisdiction (domestic vs. overseas)
- Under arrangements until 2023, overseas-based BtR investors using MITs taxed at higher rate than:
  - Domestic institutions investing in BtR
  - Overseas investors in other asset classes.
- Considered problematic because overseas investors believed likely to act as prime movers in emergence of Aus BtR sector

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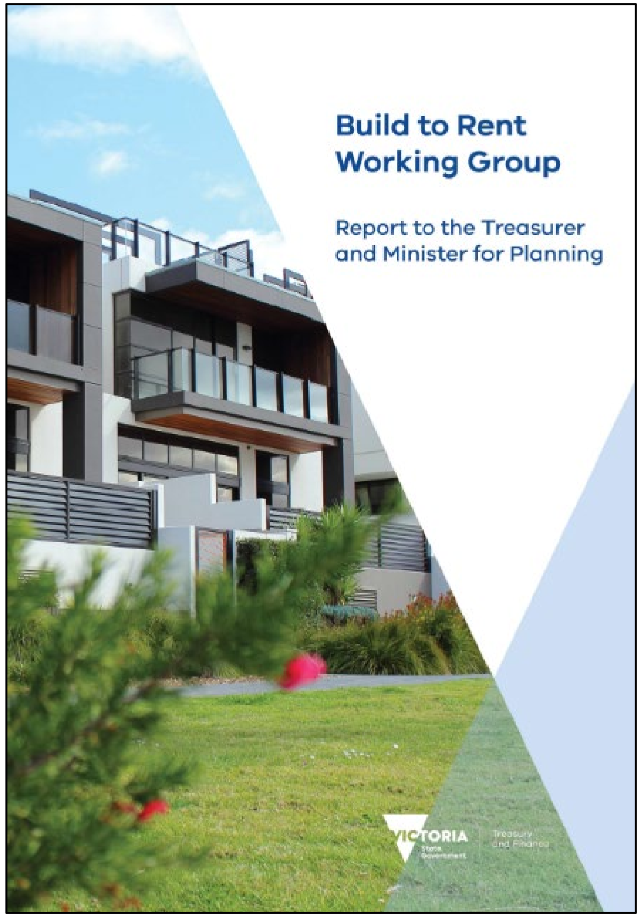
Key BtR tax liabilities – Federal Govt GST

'GST favours the development of a residential or commercial asset over BTR' (Dept of Treasury and Finance, Victoria (2020))

- GST paid on housing development costs can be reclaimed only when properties sold (therefore applicable to BtS but not BtR)
- Factoring-in GST liabilities affects BtR scheme viability – therefore depressing price BtR developers willing/able to pay for sites by comparison with BtS rivals
- GST especially challenging to reform because, although levied by Federal Govt, revenue distributed to state/territory govts



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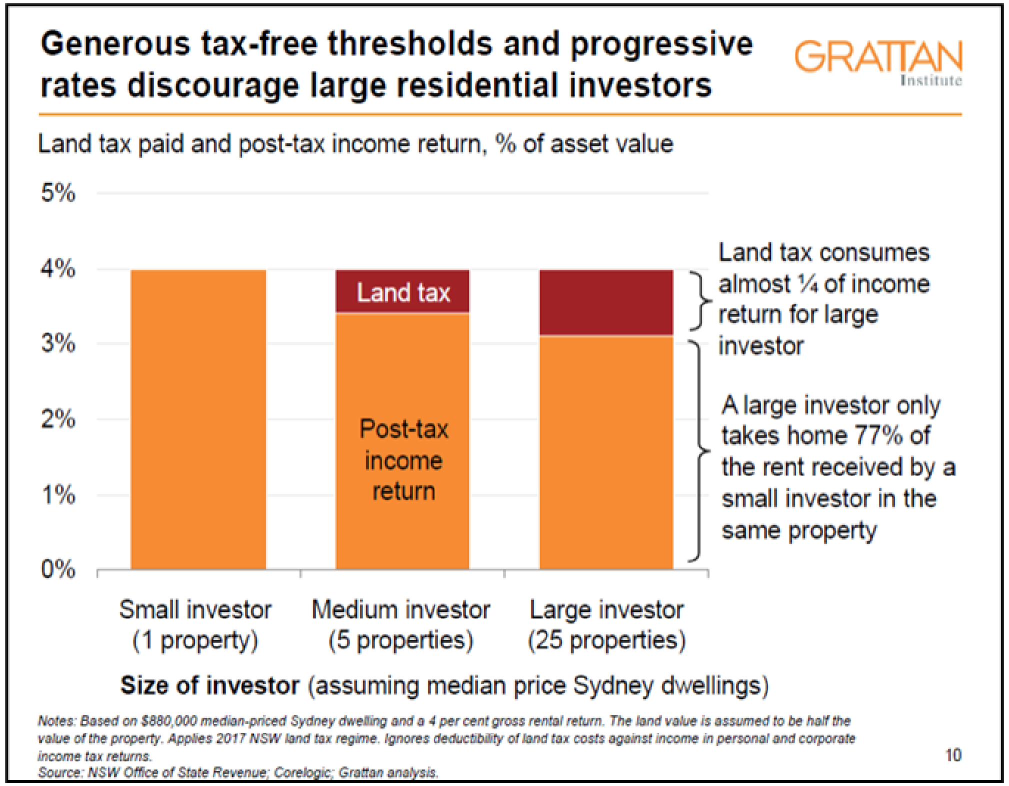
Key BtR tax liabilities – state/territory land taxes

State/territory land taxes generally feature:

- Exemption for most single property-owning ‘mum and dad landlords’ via minimum land asset ownership threshold
- ‘Progressively structured’ tax rates – effectively disadvantage larger holdings
- Such approaches arguably over-generous to small-scale investors and disadvantageous to BtR providers
- Grattan modelling contrasted zero liability for single property landlords versus ‘almost ¼ of income return for large investor’

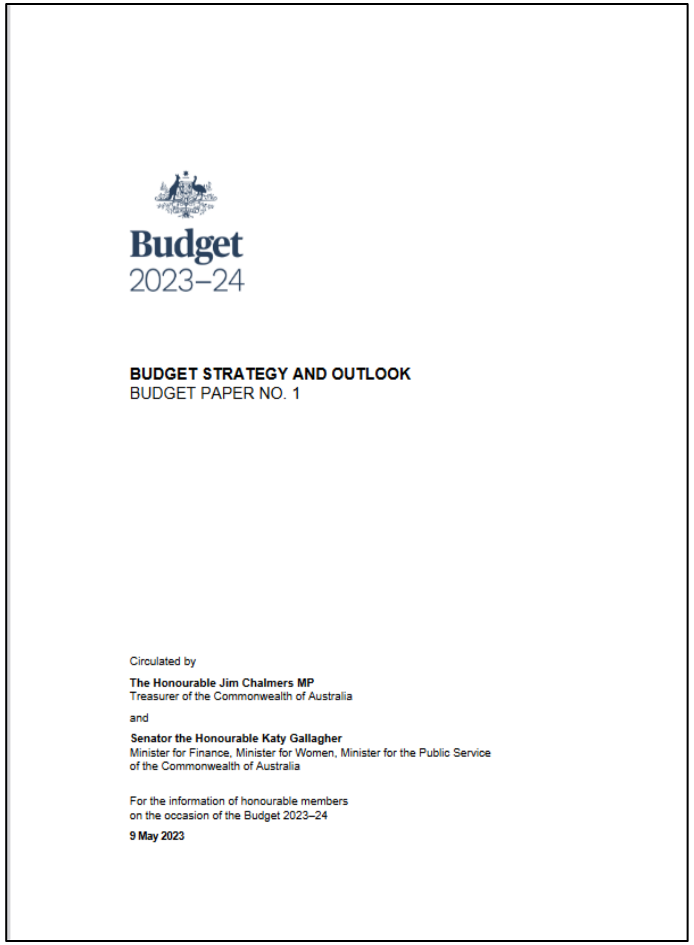


Source: Grattan Institute

3. Recent developments on tax rules affecting BtR

Federal Govt reforms – 2023 budget

- Increased annual depreciation allowance from 2.5% to 4% - i.e. allowing expenses to be depreciated for tax over a 25-year span, rather than standard 40 years
- Reduction in (overseas investor) withholding tax rate for MIT BtR-generated income from 30% to 15% for projects
- Conditional on (a) projects exceeding 49 units; (b) homes to be held under a single ownership for a minimum of 10 years; (c) unit lease terms of at least three years
- EY projected resulting increase in BtR development output from 50k to 150k over next decade


Budget
2023–24

BUDGET STRATEGY AND OUTLOOK
BUDGET PAPER NO. 1

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For the information of honourable members on the occasion of the Budget 2023–24

9 May 2023

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Recent state/territory govt tax changes

- NSW – 50% land tax reduction for eligible BtR properties from 2021 (to 2040)
- Exemption from foreign investor duty and land tax surcharges
- Conditional on schemes:
  - Exceeding 49 units
  - Remaining in single ownership for at least 15 years
  - Allowing tenants to opt for 3-year leases
- Similar concessions and qualifying rules also recently introduced in Qld, SA, Vic and WA
- In Qld and ACT concessions predicated on inclusion of ‘affordable housing’ (10% and 15%)

4. Conclusions and future prospects

Conclusions

- Significant tax changes in past 2-3 years likely to accelerate BtR development
- Implicit official acceptance that BtR can potentially fulfil broader housing policy objectives as listed on slide 6 – although few if any of these assertions underpinned by solid evidence
- Recent reforms arguably defensible on the basis of ‘levelling the playing field’ rather than ‘concessions’ as such – i.e. special treatment not afforded to other forms of housing
- Some major ‘un-level’ playing field policy settings remain in place:
    - BtR development disadvantaged in relation to BtS on GST
    - BtR developers disadvantaged in relation to individual private landlords on negative gearing and CGT discount
- Actual BtR concessions or subsidies justifiable only in exchange for developer acceptance of more substantial obligations – e.g. reservation of units for letting at sub-market rents

Key references

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