22 April 2024

The Director
Corporate Tax Policy Unit
Corporate and International Tax Division
Treasury
Langton Crescent
PARKES ACT 2600

By email: **btr@treasury.gov.au**

Dear Director

Treasury Laws Amendment Bill 2024: Build to rent developments ("Draft BtR Bill")

Thank you for the opportunity to make a submission with respect to the Draft BtR Bill.

Executive Summary

Local welcomes the proposed changes to the tax treatment of foreign institutional investment in Australian Build to Rent ("**BtR**") developments to assist in addressing Australia's housing supply and rental crisis.

However, we have grave concerns that the Draft BtR Bill will not be effective in harnessing foreign investment to stimulate significant new housing supply, and importantly creation of additional affordable rental accommodation from the BtR sector, without the following key adjustments and clarifications:

Local Recommendation	Public Benefit Achieved
1. A pro-rata reduction in the MIT Withholding Tax Rate below 15% should apply if a project contributes more than 10% affordable rental housing	Encourages a greater proportion of affordable accommodation in BtR developments

Local Recommendation	Public Benefit Achieved
2. The proposed tax concessions should apply to BtR developments under construction or operation before 9 May 2023 which incorporate 10% affordable housing	Unlocks and fast tracks the supply of over 1,100 affordable rental dwellings for Australian key workers[1]
3. The 15 year cap on reduced MIT withholding tax rate should be removed for projects that continue to provide at least 10% affordable rental dwellings after this time	Discourages affordable rental housing reverting to market rental after 15 years. This in turn avoids significant future issues for the community when this supply is withdrawn, and provides long term affordable housing
4. The 15% concessional MIT rate should apply to capital gains as well as rental revenue	Encourages offshore investment in BtR developments which contribute to housing supply and the provision of affordable rental accommodation for key workers. Without this update, foreign investment is incentivised to be directed into other property asset classes such as office, retail, industrial and student accommodation which: • attract a 15% MIT withholding tax rate without a time limit or cap; and • do not deliver equivalent public benefits.
5. A reasonable mix of apartments should be provided within a development as affordable housing rather than one of every type	Prevents BtR owners from having a perverse incentive to place residents in housing stress in order to achieve compliance (ie a penthouse apartment leased at 74.9% of market rental will still likely be unaffordable for a moderate income household). Further, this adjustment addresses practical compliance burden for the ATO and BtR owners.

[1] Based on 11,340 BtR dwellings being complete or under construction as at 4 April 2023. Source: EY (2023) A new form of housing: Build to Rent housing, https://www.propertycouncil.com.au/wp-content/uploads/2023/04/PCA-Build-to-Rent-housing-advice-Stage-1-2-Final-Public-Release-Update-04.04.23-1.pdf

Local Recommendation	Public Benefit Achieved
6. Financial and in Kind Affordable Housing Contributions should be recognised as contribution to affordable housing	Avoids foreign investment being discouraged from investing in BtR housing in markets where planning obligations require owners to make financial contributions or donate housing in kind in lieu or owning and managing affordable housing within their projects
7. The position should be maintained in the Draft BtR Bill that affordable housing can be owned and managed by BtR owners rather than mandating management by Community Housing Providers	Avoids significant cost inefficiencies and duplication associated with two managers in one building, whilst also reducing the burden on the community housing sector which is already stretched with other initiatives such as the Housing Australia Future Fund
8. Tax concessions for domestic investors in BtR assets which include affordable housing should also be introduced	Ensures that there is an incentive for all BtR developments to include affordable rental dwellings, not just BtR projects owned by offshore institutional investors.

Background

Local is a Melbourne based build to rent ("**BtR**") housing platform established in 2021 by Matt Berg and myself, in conjunction with a joint venture managed by Macquarie Asset Management Real Estate. We believe in strengthening communities by using our homes to deliver positive change.

On its establishment in 2021, Local committed to incorporate within its projects at least 10% of housing to create positive social impact, into each of our communities. Local works with registered housing providers across three groups to supply homes to people who need them; women over 55 who are at risk of homelessness, key workers who are vital to our communities, and people in need of specialist disability accommodation.

Local has a pipeline over 1,300 apartments in Melbourne, across sites in Kensington, South Melbourne and Box Hill which will incorporate over 130 dwellings to be allocated to social, affordable and specialist disability accommodation. Importantly, the vast majority of Local's current and prospective equity investors are foreign institutions which would be impacted by the proposed changes to be implemented by the Draft BtR Bill.

Overwhelming need for change in the income tax treatment of BtR investments

Australia is presently facing a significant shortfall in housing supply with significant adverse flow on effects for renters and the community more generally.

The emerging BtR sector has the capacity to play a key role in delivering much needed housing, particularly in light of the faltering build to sell market which may take many years to reset.

That said, investment in BtR housing to date has been limited. Importantly, we can confirm that an overwhelming majority of offshore institutional investors which we have engaged with over the past 3 years have cited the tax leakage on investing in Australian BtR housing compared to other property assets as a barrier to investment.

In particular, the MIT withholding tax rate for office, retail, industrial and student accommodation is 15% versus the 30% which applies to build to rent investments.

First movers such as Local's existing investors are outliers with a finite amount of capital to invest. The majority of the potential offshore investors are waiting for a more competitive tax position before moving their capital allocation from other property assets to Australian build to rent housing.

Australia does not need further investment in office buildings from offshore investors, it needs more investment in housing including with respect to affordable housing. To this end, we welcome changes to the tax treatment of foreign institutional investment in Australian BtR housing.

However, as outlined in this submission, we have grave concerns that the Draft BtR Bill will not be effective in stimulating the level of new housing supply from the BtR sector without a number of key adjustments and clarifications.

Recommendation 1 - Minimum Component of Affordable Housing

Local is supportive of the proposal to require 10% affordable housing to be eligible to receive the concessional 15% BtR tax rate.

To encourage additional much needed affordable housing supply, we submit that the MIT rate should reduce to:

- 10% in the circumstances where 15% of the project is rented as affordable housing;
- 5% in the circumstances where 20% of the project is rented as affordable housing; and
- 0% in the circumstances where 25% of the project is rented as affordable housing.

The potential public benefit of offshore investment in Australian affordable rental housing shouldn't be capped. Importantly, the more affordable housing created by this initiative, the less needed to be funded by the Federal Government.

We note that BtR in the UK successfully incorporates >10% affordable housing within each development (most ~30%) and so we see the current legislation wording not fully utilising BtR's ability to provide affordable housing.

Recommendation 2 - Significant opportunity for immediate affordable housing supply through retrospective operation

The Draft BtR Bill proposes that the MIT Withholding Tax and depreciation concessions are not available to BTR projects that commenced construction before 9 May 2023.

In circumstances where these benefits are being tied to the provision of additional affordable rental housing then we would strongly recommend that the Draft BtR Bill is amended to enable existing BTR projects, whether under construction or operational to be eligible for the proposed concessions. In particular, these benefits should receive a reduced MIT withholding tax rate if they provide 10% affordable rental dwellings into within the relevant BtR development.

For completed projects which are more than 90% leased, a transition period should apply whereby the project has until 30 June 2025 to achieve compliance noting apartments will presently be occupied by market rental paying tenants and hence some transition is required.

This change could immediately unlock over 1,100 affordable rental dwellings across Australia.[2]

Further, the proposed 9 May 2023 cut-off date will create two classes of assets, with different tax treatment which could result in those BtR assets that are not eligible for the concessionary MIT rate to be underinvested / undermaintained by owners and delivering relatively poorer housing for Australians to offset the additional tax leakage.

Recommendation 3 - The maximum period of the proposed BtR tax concessions should be removed

Presently, the MIT withholding tax and depreciation concessions for BtR developments contemplated by the Draft BtR Bill only apply for 15 years from completion of the relevant development.

Local strongly contends that there should not be a minimum period for the proposed concessions noting that ending in particular the reduced MIT withholding tax benefit after 15 years provides an economic incentive for the market to revert stock to market rental.

This will just add to a future shortfall in affordable housing and misses the opportunity for build to rent developments to contribute to the long-term supply of affordable housing in Australia.

The 15-year maximum MIT benefit period will also adversely affect the comparable investment value and accordingly attractiveness of build to rent developments to offshore investors compared to other property assets. In particular, there is no minimum period applies for office, industrial, retail, student accommodation investments which presently attract a 15% MIT withholding tax rate.

Whilst presently residential build to rent developments are attractive for offshore investors given the present depressed conditions for office and retail investments, this is a cyclical situation. When these sectors inevitably recover, offshore investment will logically favour these assets versus build to rent developments.

Removing the 15-year lease maximum MIT benefit period will maximise offshore investment in Australian rental housing and the quantum of affordable housing delivered by the proposed draft legislation.

Recommendation 4 - The MIT benefit should apply to capital gains and rental income and capital gains

Presently, the 15% concessional MIT withholding tax rate proposed by the Draft BtR Bill only apply in respect of rental income and not capital gains.

Given the proposed increase in depreciation rates from 2.5% to 4.0% p.a. for BtR assets, almost all taxable income is deferred to exit (i.e. higher depreciation reduces tax on income, but reduces asset cost base increasing the gain at eventual exit). As a result, the 15% concessional MIT rate on income currently has no benefit to foreign investors – instead their overall tax rate remains at 30%. Foreign investors would be in a better tax position with depreciation rates remaining at 2.5% if the 15% MIT rate only applies to income – i.e. the depreciation 'incentive' is actually a dis-incentive with current wording.

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[2] Based on 11,340 BtR dwellings being complete or under construction as at 4 April 2023. Source: EY (2023) A new form of housing: Build to Rent housing, https://www.propertycouncil.com.au/wp-content/uploads/2023/04/PCA-Build-to-Rent-housing-advice-Stage-1-2-Final-Public-Release-Update-04.04.23-1.pdf

Excluding capital gains on BtR from the concessional MIT rate is a different approach to what applies for applies for office, industrial, retail, student accommodation investments which presently attract a 15% MIT withholding tax rate for rental revenue and capital gains.

In doing so, as with the proposed cap of 15-years for the concessional MIT withholding tax rate, the draft legislation does not level the playing field between the income tax treatment for offshore investors between residential build to rent developments and other property assets.

Given the importance of increasing Australia's housing supply and in particular growing the supply of affordable rental dwellings, Local strongly recommends that the Draft BtR Bill is adjusted to provide that the reduced MIT Withholding Tax Rate applies to capital gains for BTR Developments consistent with the approach on other property assets delivering significantly less community benefit.

As it stands, the Draft BtR Bill will not in our view be adequate to ensure that critical offshore property investment in made in Australia's rental housing supply.

Recommendation 5 - Large penthouse apartments should not be used for affordable housing

Local supports the proposition that a broad selection of dwellings in a BTR development should be made available for affordable housing, not just the lowest standard homes.

However, the requirement in Draft BtR Bill that at least one of every dwelling type is available as an affordable dwelling is too prescriptive in our view and will create a significant compliance and verification challenge for the ATO and result inappropriate dwellings being allocated as affordable housing.

In particular, the variability of apartments within a project can be considerable. Some of Local's projects have dozens of different apartment floor plans. Further, the positioning and outlook of these apartments within a project can vary considerably. It practice, it may not be possible for one of every apartment type to be made available.

Further, this requirement could require penthouse style dwellings be leased as affordable housing. This is problematic as even at 74.9% of market rental, is unlikely to be affordable for the intended end beneficiaries meaning BtR owners have a perverse incentive to place renters into housing stress in order to comply with the legislation.

Local recommends that the approach should be for a reasonable mix of apartments in the building to be used as affordable housing with a further guidance note to be prepared which takes into account affordability, as well as housing diversity.

Recommendation 6 - Recognition of Financial and In Kind Affordable Housing Contributions

Local is strong supporter of integrating affordable housing with BtR projects rather than making financial contributions for the provision of such housing in other projects. This provides a quicker delivery of housing with improved social inclusion and community cohesion with affordable housing blended alongside market rental offerings.

However, under certain planning permits and schemes significant financial contributions are provided to Council to fund affordable housing projects in lieu of the provision of affordable housing within the project itself or otherwise require ownership by government or a community housing provider.[3]

We suggest that in circumstances where a financial or in kind contribution has been made to the provision of affordable housing for a project ("**AH Contribution**"), then a deeming mechanism should apply whereby based on the quantum of AH contribution, a project will for the purpose of eligibility for the proposed BtR

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[3] For example the City of Sydney Affordable Housing Program (https://www.cityofsydney.nsw.gov.au/affordable-housing-contributions/city-of-sydney-affordable-housing-program)

tax concessions to have provided an agreed quantum of affordable housing. We suggest a sliding scale is formulated which is then indexed annually to CPI. To the extent the financial contribution is less than necessary to equate to a 10% affordable housing contribution, then additional 'top up' affordable housing is to be provided by the project.

This will ensure equitable treatment of projects where material affordable housing contributions are being made. Importantly, avoids the likely scenario that such projects become unattractive for foreign investment.

Recommendation 7 - Enabling affordable housing in BtR Developments to be owned and managed by BtR owners

A significant positive feature of the Draft BtR Bill is the proposition that affordable housing can be owned and managed by BtR Owners rather than Community Housing Providers. BtR Owners will inherently be large rental providers with management contracts in place for the totality of the buildings in question. Enabling BtR Owners to manage the affordable housing within their projects creates a significantly more seamless and efficient experience than mandating a charity or community housing provider to manage such dwellings.

Local has partnered with Women's Property Initiatives in Melbourne on its initial projects and we highly value the partnership in circumstances where we are providing social housing for women and families. However, for the management of affordable and key worker housing there would be significant inefficiency and additional cost mandating a BtR owner to employ a Community Housing Provider to manage affordable dwellings within a BtR Development.

In particular, Community Housing Providers understandably want to be remunerated for the leasing of these dwellings which is an additional cost to Local which already have an onsite management team in place responsible for managing the entire building inclusive of the market rental dwellings. In addition, the Community Housing sector is significantly stretched with initiatives such as the Housing Australia Future Fund hence having them also be co-opted to participate in the management of affordable housing in BtR developments will future limits the capacity and social impact of the sector.

In this regard we suggest that annual reporting coupled with the ATO's audit rights will be adequate to ensure compliance by BtR operators with their affordable housing commitments noting the very significant penalties which would be applicable in the event of non-compliance. To this end, we also believe that tools such as Housing All Australians' affordable housing register proposed to be delivered in conjunction with PEXA could also significantly assist in promoting implementation and compliance with the initiatives proposed in the Draft BtR Bill.

Recommendation 8 - Tax concessions for domestic owners of BtR assets should also be considered

Whilst the early movers in the Australian BtR sector have been offshore institutional investors, Australian investors have also participated in the emergence of the sector. Importantly, this is expected to increase over time as the sector grows.

Local is concerned that the Draft BtR Bill does not incentivise the retention of affordable housing in BtR assets which are subsequently acquired by domestic investors from offshore institutional investors. Nor does it provide an incentive for Australian investors to include affordable rental housing when developing new BtR projects.

To maximise the potential of the BtR sector to deliver affordable rental accommodation for the Australian community, we would suggest that the opportunity should be taken to introduce income tax concessions for domestic BtR investors which incorporate affordable housing in their projects.

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Thank you for the opportunity to provide this submission and please do not hesitate to contact me if you require any further information.

Yours sincerely,

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