PROPERTY COUNCIL of Australia

Australia's property industry
Creating for Generations

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Committee Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

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

11 October 2018

Dear Mr Fitt

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

The Property Council of Australia welcomes the opportunity to comment on these Bills (together "the proposed legislation").

The Property Council believes it is of overriding importance that the market can be certain of the investment framework for stapled structures moving forward. We encourage the Parliament to resolve the remaining policy issues and adopt the proposed legislation, unamended if necessary, to avoid further uncertainty and delay.

The attached Property Council submission:

1. Sets out the significant economic contribution that is made by Australia's world class managers of commercial real estate and the critical importance of having stable and competitive investment settings.
2. Strongly supports the certainty provided through having a settled stapled structures framework moving forward. The proposed legislation promotes the interests of the 14.8 million Australians who invest in commercial property through their superfunds and has been arrived at after significant consultation.
3. Acknowledges the importance of transitional measures for long-established property groups – including those in the hotel and retirement living sectors – which have legitimately established their businesses under the current law and will be adversely impacted by the proposed legislation.
4. Strongly supports the inclusion of Build-to-Rent housing within the managed investment trust framework as a crucial precursor to the establishment of this form of rental housing in Australia, however argues that imposing a 30% withholding tax on international capital will result in less Build-to-Rent housing than would otherwise be the case.
5. Seeks to address a potential unintended outcome for the student accommodation sector which will result in international capital providers being taxed at 30%. The proposed drafting puts off-campus student accommodation at odds with other "commercial residential" assets

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and could give rise to further unintended consequences for the tertiary education sector which relies on international capital to provide purpose-built student accommodation for higher education students.

6. Strongly supports the inclusion of affordable rental housing within the managed investment trust framework with an incentivised withholding tax rate, however we believe this incentive would be more powerful if this was set below the standard 15% withholding tax rate at 10% – similar to that provided under the current managed investment trust legislation for clean building projects.

7. Notes the importance of attracting international capital to underpin the supply of new commercial and residential property for Australians and welcomes a broader dialogue on how this capital can play a role in boosting housing affordability, choice and supply.

We welcome the opportunity to appear before the Senate Standing Committee on Economics to discuss these issues further. Please do not hesitate to contact Belinda Ngo on 02 9033 1929 or bngo@propertycouncil.com.au should you wish to discuss this submission.

Yours sincerely

Ken Morrison
Chief Executive

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of Australia

Submission:

Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax and Other Measures) Bill 2018

October 2018

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1. About the Property Council

The Property Council of Australia champions the industry that employs 1.4 million Australians and shapes the future of our communities and cities.

Property Council members invest in, design, build and manage places that matter to Australians: our homes, retirement villages, shopping centres, office buildings, industrial areas, education, research and health precincts, tourism and hospitality venues and more.

On behalf of our members, we provide the research and thought leadership to help decision-makers create vibrant communities, great cities and strong economies.

We support smarter planning, better infrastructure, sustainability, and globally competitive investment and tax settings which underpin the contribution our members make to the economic prosperity and social well-being of Australians.

Property industry by numbers

- $202.9 billion contribution to Australia's GDP (13%)
- 1.4 million jobs, more than mining and manufacturing combined
- More than 1 in 4 people derive their wage from the property industry directly or indirectly
- $87.9 billion in taxes paid to federal, state and local governments
- 14.8 million Australians have a financial stake in property through their superfund

2. Executive Summary

The Property Council believes it is of overriding importance that the market can be certain of the investment framework for stapled structures moving forward.

We encourage the Parliament to resolve the remaining policy issues and adopt the proposed legislation, unamended if necessary, to avoid further uncertainty and delay.

The Property Council submission:

1. **Sets out the significant economic contribution that is made by Australia's world class managers of commercial real estate and the critical importance of having stable and competitive investment settings.**

   Australian property funds are well-placed to bring their world class sustainability, management and commercial skills to finance, develop and manage property assets for the benefit of the community. Significant investment in real estate and infrastructure will be required to ensure our cities remain both liveable and continue to be engines of economic prosperity. However, Australia's ability to attract the requisite capital to fund our cities of the future will also depend on the attractiveness of the regulatory and tax framework that underpins our property funds management sector.

2. **Strongly supports the certainty provided through having a settled stapled structures framework moving forward. The proposed legislation promotes the interests of the 14.8 million Australians who invest in commercial property through their superfunds and has been arrived at after significant consultation.**

   Stapled structures have been in operation in Australia since 1988. A stapled structure allows property groups to 'staple' together passive investment in institutional real estate with an active property business (such as development) under the one ownership structure with each part of the business taxed appropriately. The proposed legislation recognises the long-standing legitimate use of stapled structures in the property industry and notes that this has not been the cause of the Government's integrity concerns.

3. **Acknowledges the importance of transitional measures for long-established property groups – including those in the hotel and retirement living sectors – who have legitimately established their businesses under the current law and will be adversely impacted by the proposed legislation.**

   The focus on third party rent in the stapled structures package and the changes to tax settings for residential assets will impact long-established businesses in various sectors, including hotels and retirement living. The property industry acknowledges the challenges with developing a targeted solution and appreciates the consultative process which has been undertaken in arriving at the proposed transition timeframes over the 18 months since the initial review began.

4. **Strongly supports the inclusion of Build-to-Rent housing within the managed investment trust framework as a crucial precursor to the establishment of this form of rental housing in Australia, however argues that imposing a 30% withholding tax on international capital will result in less Build-to-Rent housing than would otherwise be the case.**

   The proposed legislation makes clear that institutional investors can continue to invest in residential investments through a managed investment trust (MIT). This is critical for existing asset classes such as student accommodation and retirement villages and is an absolutely vital step to enabling the creation of a Build-to-Rent housing asset class in Australia. It also

facilitates mixed-use developments (i.e. precincts with retail, office and residential components) which are highly encouraged by state and local governments to create active communities.

However, imposing a 30% rate in Australia for Build-to-Rent will inevitably make these investments less attractive for long-term patient global capital and result in less Build-to-Rent housing being created than would otherwise be the case. We submit that withholding tax rates should be sector neutral and should also be set at 15% for Build-to-Rent housing (for eligible countries). A 15% MIT withholding tax rate is comparable with that payable by domestic superfunds (15% on income and 10% on capital gains) as well as the tax rates paid by international investors who invest into the US, UK and Canadian institutional real estate markets.

5. **Seeks to address a potential unintended outcome for the student accommodation sector which will result in international capital providers being taxed at 30%. The proposed drafting puts off-campus student accommodation at odds with other "commercial residential" assets and could give rise to further unintended consequences for the tertiary education sector which relies on international capital to provide purpose-built student accommodation for higher education international students.**

   Critically, the proposed changes to the definition of residential premises inadvertently puts student accommodation at odds with the long-standing treatment of student accommodation as 'commercial residential' premises and would double their withholding tax rate to 30%. This would have a significant impact on the student accommodation sector (which is heavily reliant on offshore capital) and on the growth plans of universities. This change was not canvassed in previous drafts and is a late issue that can be corrected with a minor drafting change.

6. **Strongly supports the inclusion of affordable rental housing within the managed investment trust framework with an incentivised withholding tax rate, however, we believe this incentive would be more powerful if this was set below the standard 15% withholding tax rate at 10% – similar to that provided under the current managed investment trust legislation for clean building projects.**

   The Property Council strongly supports the concept of incentivising investment into affordable rental housing within the MIT framework. The creation of targeted affordable rental housing available for key workers is an important part of the solution to Australia's housing affordability challenges, and incentives that encourage the private sector to deliver affordable rental housing would be welcome.

7. **Notes the importance of attracting international capital to underpin the supply of new commercial and residential property for Australians and welcomes a broader dialogue on how this capital can play a role in boosting housing affordability, choice and supply.**

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3. Context

In March 2017, the Government released a consultation paper outlining concerns with the growing use of stapled structures to inappropriately recharacterise trading income to passive income. The concerns related to situations where a single business was fragmented in a contrived way to take advantage of favorable tax rates.

Importantly, the consultation paper noted that stapled property groups that derive large portions or all of their income as rental from third party tenants "fall well within the original policy intent" of the tax rules[1].

In parallel, the Government's 2017-18 Federal Budget included a proposal to encourage long-term institutional investment in affordable housing. This resulted in draft legislation released for consultation in September 2017 which proposed to ban MITs from holding residential property, other than affordable housing or commercial residential premises.

Over the past 18 months, there has been significant consultation between Government, Treasury, ATO and industry in relation to the tax arrangements for stapled structures and the tax arrangements for institutional investment in residential assets. The proposed legislation reflects the culmination of these consultations.

[1] Treasury, Stapled Structures Consultation Paper, March 2017, page 7

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4. Role of international capital in shaping our cities

Australia's investment needs

Looking ahead, Australia's need for investment will continue to grow strongly.

Australia is the most urbanised country in the world and many of our cities are growing strongly. The resulting growth and change in our cities will increase the need for investment in these locations. For example, Sydney and Melbourne are expected to accommodate another three million residents by the mid-2050s while southeast Queensland and Perth are expected to add another two million each.

This growth will require significant investment in real estate and infrastructure to ensure our cities remain both liveable and continue to be engines of economic prosperity. We will need more homes, offices, retail centres, industrial sites, retirement living, student accommodation, hotels and community, cultural and sporting precincts. State and local governments are also encouraging greater medium and high-density housing and mixed-use developments (i.e. precincts with retail, office and residential components) to create active communities.

The real estate sector also underpins the strength of other critical aspects of our economy – for example, hotels facilitate the tourism sector as well as conferences and exhibitions, and student accommodation reinforces Australia's position as a world class tertiary education destination.

Importance of strong domestic and international capital flows

Commercial real estate is an attractive investment for long-term patient capital investors such as superfunds and sovereign wealth funds. It provides a relatively predictable rental income return and helps diversify portfolios beyond equities and bonds.

Australian superfunds play a significant role in financing the Australian commercial real estate sector – however, Australian superfunds cannot meet all of the potential investment opportunities available, and many superfunds are also looking to diversify their portfolios by investing in offshore markets.

Without additional international capital, many investment opportunities in Australia would be delayed or not proceed. For example, over the past 25 years, the gap between Australia's domestic savings and its investment needs has been around 4% of GDP – in 2015/16 alone, this represented $67 billion worth of investments[2] which were funded with international capital.

It is also important for Australia to have a deep and stable pool of investment capital which brings together both domestic and international sources of capital.

Without strong and stable flows of both domestic and international capital, the pressure to fund these significant investments will fall back to governments and will put further strain on government budgets. Or worse, Australians will simply not have the real estate assets needed to sustain our quality of life. We could also create impediments for our tourism and tertiary education sectors which are a significant contributor to our economy.

Industry understands that we need to have the right tax policy settings to ensure governments have sufficient revenues to provide the services that Australians need. However, this must be carefully balanced with the critical need to continue to attract and retain international investment to underpin our economic growth and prosperity.

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[2] ACIL Allen Consulting, Benefits of foreign investment in Australian real estate, 2017

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5. A globally competitive property funds management regime

Currently in Australia, property funds are typically established as MITs or stapled groups. These investment vehicles are the means to attract the investment which provides our homes, sustainable cities and buildings, retail and entertainment precincts and build strong communities.

Role of MITs for property investment

A MIT is a type of collective investment vehicle which is widely held and primarily makes passive investments. It allows the pooling of funds from both institutional and 'mum and dad' investors – both domestic and international.

The purpose of collective investment vehicles in the property sector is to provide investors with the opportunity to:

- invest in large scale real estate assets they could not own directly;
- benefit from the market experience and insights of professional asset managers;
- provide liquidity to investment in large real estate assets that would otherwise be highly illiquid; and
- diversify their investment portfolio to reduce the risk from market downturns.

MITs are subject to a robust tax and regulatory framework that provides investor protections, such as ASIC licensing requirements and continuous disclosure requirements under ASX listing rules (for listed entities).

The MIT tax framework was most recently reviewed and modernised in 2016 to enhance the competitiveness of Australia's funds management industry. Importantly, in order to access the MIT 15% withholding tax rates, the MIT must have sufficient management in Australia which promotes local expertise.

The MIT rules are also sufficiently robust to ensure a non-resident individual cannot inappropriately access the MIT withholding tax rates by setting up a MIT. In order to qualify as a MIT, the trust needs to be widely held which by definition requires at least 25 members, with special rules applying for institutional investors who are recognised as being widely held. Importantly, a trust will not qualify as a MIT if its ownership is concentrated among non-institutional investors i.e. 10 or less investors own 75% or more of the MIT, or any individual non-resident owns 10% or more.

MITs are limited to activities which are primarily passive in nature, reflecting the desire for the use of this vehicle for stable long-term patient capital.

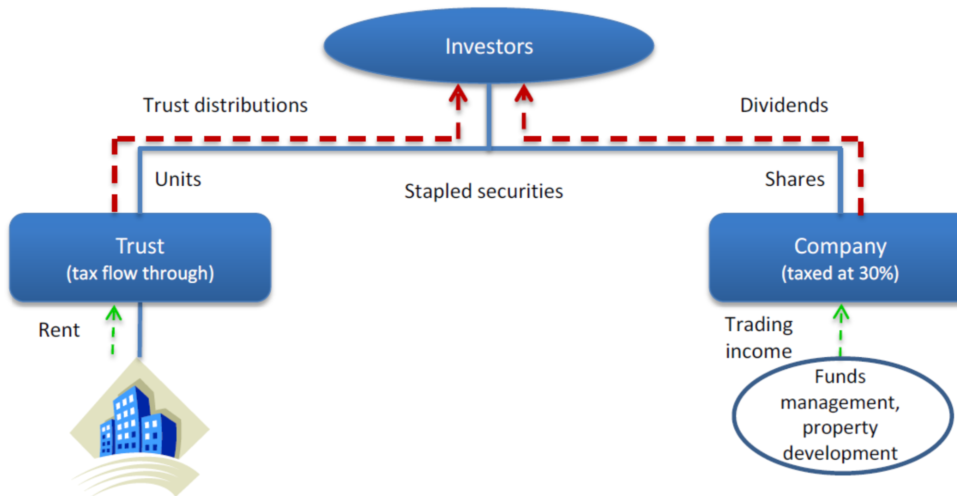
Role of stapled groups for property investment

Australia's first listed property trust emerged on the ASX in 1971, and the first stapled property group came into operation in 1988.

A stapled structure allows property groups to 'staple' together passive investment in institutional real estate with an active property business (such as development) under the one ownership structure with each part of the business taxed appropriately. It allows groups to leverage their expertise and capital across different property sectors and cycle.

From an investor's view point this is a single investment. From a taxation and legal view point this is an investment in the securities of two or more separate entities that can only be traded together as one investment (the "stapled security").

A simplified example of a stapled property group is set out below:



Importantly, stapling allows property groups to:

- **internalise their management** (i.e. the unitholders in the MIT also own the trustee) – this reduces operating costs paid outside the group and can reduce perceived conflicts of interests between asset owners and external managers.

- **run an integrated platform** that includes not just passive ownership of real estate but complementary operational businesses such as funds management and development activities – this creates efficiencies for property groups and an additional income stream where services are provided to third parties.

- **diversify into mixed use of assets** – e.g. combining retail, office, hotel and housing (Build-to-Rent, student accommodation, seniors living) in the one precinct. This is a core planning objective for many state and local governments as they look to create liveable cities.

Tax settings for MITs and stapled property groups

Companies (or trusts carrying on a trading business) in the stapled group are taxed on their profits at the company tax rate.

MITs are effectively taxed on a flow through basis. This means the net rental income from the MIT flows annually to the investor who then pays tax on their share of the net income, at their individual tax rate.

This is consistent with globally accepted policy settings for institutional investment in real estate. For example, the OECD commentary on the model tax convention discusses the importance of neutrality between direct investments and investments through a collective investment vehicle. Further, both the Johnson Report and the Murray Financial System Inquiry have recognised and championed the critical importance of having tax flow through collective investment vehicles to attract international capital to Australia.

To ensure the efficient collection of Australian tax, non-resident investors in MITs pay a final withholding tax on their share of the MIT's Australian sourced taxable income.

Australia imposes withholding tax rates of either 15% for investors from an Exchange of information (EOI) country, or 30% for all other investors. As explained in the explanatory memorandum accompanying the proposed legislation, the 15% rate was introduced to *"increase*

the attractiveness of Australia's fund management industry, especially property funds, to mobile foreign investment" (para 1.6). Due to the extension of the number of EOI countries in the 2018-19 Federal Budget, 112 countries in the world are now subject to the 15% MIT withholding tax rate. This includes nearly all major trading partners, making the 15% rate effectively the default rate rather than a concession.

Comparison of tax rates

Australia's tax rates for non-resident MIT investors are currently comparable to the tax rates payable by international investors in the US, UK and Canadian institutional real estate markets.

The MIT withholding tax rates were adjusted in 2012, increasing the concessional rate from 7.5% to 15% (the non-concessional rate remained at 30%).

The impacts of the proposed increase were considered by the House of Representatives Standing Committee on Economics which commented that *"Treasury reiterated that the headline tax rate at 15 per cent is 'broadly in line with other advanced economies…"*.

Treasury's comments of 2012 remain applicable and continue to be reflected by the current withholding tax rates in the US, UK and Canada:

	Australia	**US/UK/Canada**
Concessional rate[3]	15%	15%
Non-concessional rate	30%	20-30%

It is noted that in the period since the rate was increased to 15%, the US has introduced lower taxes on foreign investment in real estate (the US FIRPTA rules) and lower taxes on pension funds. It is critical that our regime remains competitive if we are to continue to attract international capital to Australia.

The MIT withholding tax rate of 15% is also in line with the Australian domestic rate applicable to both institutional and self-managed superannuation funds, being 15% for income and 10% on capital gains.

[3] Provided under domestic law or tax treaty

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6. Stapled property groups are not an integrity risk

The review into stapled groups arose due to concerns that stapled structures were being used in non-property businesses to artificially convert active income (taxed at the 30% corporate tax rate) into passive income (which is eligible for the 15% MIT withholding tax rate).

Property groups do not use stapled structures to fragment integrated businesses. Rather, stapled structures are used to combine complimentary businesses, most typically in the form of "internalising" activities that would otherwise be performed by unrelated parties.

The explanatory memorandum to the proposed legislation acknowledges this by saying (at para 1.8):

> *"This does not raise significant integrity issues for traditional property stapled structures. The trust side of traditional property stapled structures generally hold portfolios of land assets that derive passive rental income from third party tenants. A lower tax rate on this income is an intended outcome of the MIT regime. Trading activities (for example, property development) are undertaken by the company side of the staple, which continues to pay corporate tax. There is no conversion of active income into passive income."*

Impact for the commercial and retail real estate sectors

The proposed legislation will continue to allow property groups to utilise stapling arrangements to support different operating models and different scales of activity across the whole spectrum of property – from development and funds management (in the company) to long-term property ownership (in the trust or MIT), with each part of the business taxed appropriately.

The Government's integrity concerns on the misuse of stapled structures is addressed by applying a 30% withholding tax to distributions derived from trading income that has been converted into passive income using a MIT, excluding rent received from third parties. Accordingly, the proposed legislation should have minimal impact for the core commercial real estate sectors.

Impact for the hotel sector

Stapled structures have long been used by the hotels sector to internalise activities that could otherwise be performed by unrelated parties. Internalising activities provides significant commercial benefits for hotel property groups and their investors, including that it:

- allows hotel stapled groups to earn trading income that is taxed at the corporate tax rate while at the same time generate an arm's length amount of rental income from passive real estate assets;
- better aligns managers with long-term investor interests;
- creates competition and encourages innovation;
- diversifies risks and returns for investors; and
- leverages capital and unique property expertise to maximise value for investors and the broader community.

Importantly, stapling together the ownership of a hotel with the management of a hotel presents little risk of revenue leakage to the Government. There are sufficient safeguards in the tax law that requires transactions between companies and MITs to be on arm's length terms.

Unfortunately, under the proposed staple structure arrangements, hotels which are internally managed will be subject to 30% withholding tax even though the income is ultimately derived from the occupation of physical space. This is because the carve out from the 30% withholding tax

rate only extends to "rent" received from third parties, and third party income for a hotel group is not typically in the form of rent.

This means the tax outcomes for an internally managed hotel will put it at a disadvantage to an externally managed hotel which remains eligible for the 15% MIT withholding tax rate.

Given the above-mentioned benefits of internal management, the proposed change could have a detrimental impact on the attractiveness of future investment in the hotel sector – which could then have negative flow-on effects for our tourism sector as well as conferences and exhibitions.

Impact for the retirement and seniors living sector

Australia, like many societies, has an ageing population. In 2017 there were 3.8 million Australian's 65 years and over representing 15% of the population,. This percentage is likely to increase to almost 25% by 2057[4].

Retirement villages provide an opportunity for individual independent living for those who wish to live in a community of people of a similar age while balancing increasing requirements for care. Currently nearly 200,000 Australians live in retirement villages[5].

The benefits of a retirement/seniors living sector includes:

- **Reduced pressure on government funded aged care services** – the proportion of senior Australians who receive taxpayer funded community packages is significantly smaller among those who live in retirement villages as opposed to those who live at home in the wider community.

  Government spending on aged care is predicted to increase over the medium term from 0.9% of GDP in 2014-2015 to 1.7% of GDP in 2054-55[6].

  Due to the age appropriate and purpose-built design of retirement villages there can be less need for personal care. Retirement village residents typically enter (government funded) residential aged care facilities 5 years later than their peers living in the wider community, therefore saving 5 years of residential aged care funding.

- **Ensuring the good health and wellbeing of older Australians** – retirement villages are especially designed for older people and can help alleviate concerns such as loneliness and social isolation.

  The Productivity Commission found that "age-friendly housing and neighbourhoods can have a positive effect on the health and quality of life of older Australians" [7].

Under the current law, the market can determine the most appropriate ownership model for retirement and seniors living – whether this is held in a company, a trust or an MIT subject to the satisfaction of passive income requirements. The law allows each operator to determine the optimal structure based on its business model, investors and stakeholders.

The proposed stapled structure arrangements will reduce the flexibility for the retirement and seniors living sector to utilise this investment framework. This could adversely impact the much-needed development pipeline required for our ageing population.

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[4] ABS 2017 – Australian Institute of Health and Welfare, 10 September 2018

[5] Grant Thornton, expected release 2018, Overview of the Australian Retirement Village Sector

[6] Intergenerational Report Australia in 2055, March 2015, page xvii

[7] Productivity Commission, 2011, Caring for Older Australians Inquiry Report, Vol 2, p.275

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Transitional arrangements for impacted sectors

The property industry acknowledges the challenges with developing a targeted solution and appreciates the consultative process which has been undertaken in arriving at the proposed legislation over the 18 month period since the initial review began.

While we are disappointed with the impacts for the hotel and retirement living sectors, we appreciate the transitional measures for existing investments which provides welcome relief for long-established property groups that have legitimately established their businesses under the current law and will be adversely impacted by the proposed legislation.

Given the overriding importance of providing certainty of investment in the crucial stapled structures framework, we support adoption of the proposed legislation to avoid further uncertainty and delay.

7. Institutional investment in residential housing

Globally, Build-to-Rent housing attracts significant investment from sophisticated institutional investors – including superfunds, sovereign wealth funds and insurance companies. The US, UK, Canada and other jurisdictions have been able to tap into this institutional capital to transform the supply of purpose built rental housing and improve the quality and availability of housing choice for renters.

As noted above, Australia's tax and regulatory settings play a crucial role in either supporting or discouraging investment.

Under the existing MIT framework, institutional investment in residential assets is treated in the same manner as investments in other forms of passive real estate investments. This is consistent with the market view where investing in residential assets is akin to investing in an office or shopping centre as each investment proposal is considered primarily on income yield derived from rents.

Under the proposed legislation:

- institutional investors will continue to be able to invest in residential investments through a MIT;
- international investors in affordable housing MITs will be taxed at 15%;
- international investors in commercial residential premises MITs will be taxed at 15%; and
- international investors in all other forms of residential premises will be taxed at 30%.

Impact of clarity on MIT treatment

Australia's MIT regime is a well-known institutional investment vehicle that provides the platform to attract the requisite capital to the Australian real estate market.

The ability to hold residential investments in a MIT is an absolutely vital step to enabling the creation of a Build-to-Rent housing asset class in Australia. It also facilitates mixed-use developments (i.e. precincts with retail, office and residential components) which are highly encouraged by state and local governments to create active communities.

Impact of increased withholding tax rates on residential investment

Unfortunately, the proposed legislation seeks to impose a 30% MIT withholding tax for international investors in residential assets (other than affordable rental housing).

The existing 15% MIT withholding tax rate is comparable with the tax rate payable by domestic superfunds (15% on income and 10% on capital gains) as well as international investors in the US, UK and Canadian institutional real estate markets.

Imposing a 30% rate in Australia will reduce our international competitiveness and make us a less attractive destination for long-term patient global capital. This is important because investment decisions are based on after-tax returns and pension funds and sovereign wealth funds are typically lowly taxed in their home jurisdictions.

This will act as a disincentive for future investment in Australia's Build-to-Rent housing sector which provides significant benefits for everyday Australians and the broader economy.

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Benefits of Build-to-Rent housing

Build-to-Rent is a well-established housing option internationally, providing long term rental accommodation and a better-quality rental experience. Governments overseas have facilitated the emergence of this asset class to encourage housing diversity and increase housing supply.

A healthy Build-to-Rent housing sector is closely aligned with the Government's commitment to improve housing affordability, create jobs, maintain economic growth, and importantly attract significant investment into the supply of affordable rental housing.

The benefits of a Build-to-Rent housing sector includes:

1. A better-quality experience for people who rent

- longer tenure options
- purpose-built facilities with common areas, concierge services and pooled amenities
- a curated approach to community
- professional management

2. An additional source of housing supply that is not linked to traditional build-to-sell construction cycles

- the Government has rightly prioritised initiatives to encourage more housing supply to address housing affordability in a sustainable way
- normal build-to-sell housing construction will occur when a developer believes they can sell for a profit – supply surges and slows as a result
- Build-to-Rent housing creates an asset designed to generate long term rental income flows
- while build-to-sell will always be the dominant source of housing supply, Build-to-Rent can provide additional supply that is not linked to traditional construction cycles – securing jobs
- this additional supply is a key reason for the UK Government's strong support for the Build-to-Rent sector in that country
- in the US, investment in multi-family housing actually increased following the GFC.

3. A willing partner to achieve a pipeline of affordable rental housing

- Commonwealth, state and local governments are increasingly interested in incentivising the provision of affordable rental housing
- a healthy and growing Build-to-Rent sector provides the best platform for governments to deliver this outcome
- governments can incentivise this outcome through tax concessions, density bonuses or mandating outcomes on the disposal of government land
- without a healthy at-market Build-to-Rent housing sector, there is less likely to be a take-up of such government incentives at a scale that will be required to meet the housing needs of our large cities.

Based on the experience in overseas markets, the key to a successful Build-to-Rent housing sector is scale – this means it is essential to attract investment capital to deliver quality rental accommodation.

Given the newness of the Build-to-Rent asset class in Australia, it will be necessary to harness international institutional capital initially, as they have more experience with this asset class compared to domestic superfunds. We understand from our discussions with domestic superfunds that most would prefer to hold off investing in an Australian Build-to-Rent housing sector until it has matured and they can be confident of the depth of the market. In the longer term, having

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access to deep and liquid capital markets is critical to provide confidence for both domestic and international capital.

Impact for affordable rental housing

The proposed legislation also provides clarity that institutional investors can invest in affordable rental housing through a MIT vehicle, with non-resident investors taxed at 15%.

The Property Council strongly supports the concept of incentivising investment into affordable rental housing within the MIT framework. The creation of targeted affordable rental housing available for key workers is an important part of the solution to Australia's housing affordability challenges, and incentives that encourage the private sector to deliver affordable rental housing would be welcome. It should be noted that such incentives are much more likely to be successful if there is a robust Build-to-Rent housing sector which is able to utilise these incentives to deliver affordable rental housing within their projects.

However the proposed withholding tax rates for affordable rental housing are set at 15%, the same rate as investment in commercial property from eligible countries. This incentive would be more powerful if it was set below this standard 15% rate, preferably at a 10% withholding tax rate similar to that provided under the current MIT legislation for investments in energy efficient developments (known as clean building MITs).

8. Unintended consequences for tertiary education sector

The proposed drafting of the MIT residential tax changes capture off-campus student accommodation as a residential investment which will be taxed at 30% for international investors, rather than a "commercial residential" investment taxed at 15%. This will give rise to unintended consequences for the tertiary education sector, which relies on international capital to provide purpose-built student accommodation for higher education international students.

Critically, the technical change to the definition of residential premises was not canvassed in previous drafts of the legislation released for consultation and is at odds with the treatment of other 'commercial residential' assets.

Benefits of student accommodation

Australia's tertiary education sector is one of our primary exports. The growth in international students studying at Australian universities has led to the need for purpose-built student accommodation.

Purpose-built student accommodation is different to other classes of residential assets with significant shared facilities including common rooms, laundry and gyms. These buildings are usually managed by an on-site team who have responsibility for the running of the buildings, providing maintenance and conducting interviews for new tenants.

There are also typically conditions placed on student accommodation projects which limit the use of the land for other purposes – for example, conditions under FIRB approvals, local council development approval requirements, caveats on the land title and zoning limits.

The proposed legislation contains an express carve out for 'commercial residential premises', which is a term used in the GST legislation and includes sectors such as hotels, hostels and boarding houses.

Commercial residential premises have long been distinguished from residential because of different attributes such as they:

- are run by a controller for a commercial purpose;
- have multiple occupancies;
- are held out to the public as such;
- have a central management;
- provide services in addition to commercial accommodation; and
- are used primarily for accommodation.[8]

Most relevantly, in 2012, there was a court decision that specifically confirmed that student accommodation which satisfied the above features (typically off-campus student accommodation) could fall within the 'commercial residential premises' definition. This has also been acknowledged and confirmed by the ATO in a tax ruling (GSTR2012/6). In particular, the features of student accommodation were held to be akin to a hostel and satisfied the definition of commercial residential property.

Despite this, the proposed drafting treats student accommodation as if it were residential premises, rather than commercial residential premises. This exclusion from commercial residential premises

[8] para 15.12 of the Explanatory Memorandum to the 2006 amendments and discussed in *GSTR 2012/6: Goods and Services Tax: Commercial Residential Premises*

was not publicly canvassed during consultation on earlier drafts of the legislation and puts off-campus student accommodation at odds with the broader commercial residential premises sector.

Australia's commercial purpose-built student accommodation sector is valued at approximately $8bn, representing approximately 44,000 dedicated beds across all states and territories. The sector was projected to increase to 70,000 beds by 2022[9].

We understand that international institutional investors have been the predominant source of capital behind the commercial purpose-built student accommodation sector.

The imposition of a higher withholding tax on student accommodation will act as a significant disincentive for existing and future investment in this asset class.

Any reduction in the supply of purpose-built student accommodation could place further pressure on housing markets, particularly in areas near university precincts. If students are unable to find beds in purpose-built student accommodation they will need to turn to the private rental/sales market for their housing needs.

We are also aware of circumstances where universities are guaranteeing accommodation to attract international students – if these beds are not able to be provided this could adversely impact the tertiary educational sector.

Technical amendment

These unintended consequences can be easily alleviated by clarifying that student accommodation, which satisfies the commercial residential premises requirements, will be treated in the same manner as other forms of commercial residential premises.

[9] Savills, 2018

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