

Session 7: Build-to-Rent: Where are we now?

Speakers: Jennifer McCosker, Partner

CPD Category: Substantive Law

3:00 PM – 4:00 PM (AEDT)



Everyone's lines are muted upon entry. We will open the lines up after the session for Q&A.



If you want to ask a question, use the chat icon (along the bottom of your screen) to send a message to the speakers.



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K&L GATES



Wednesday 21 February 2023

Build-to-Rent: Where are we now?

Jennifer McCosker, Partner | Real Estate

Topics we Propose to Cover

1. What is BTR?
2. BTR Sector – Local and Global
3. Tax Impediments
4. Benefits of Residential Tenancy
5. Affordable Housing Initiatives
6. BTR and Sustainability
7. Debt Funding - Housing Australia (HA) and Housing Australia Future Fund (HAFF)
8. Tax Exemptions and Incentives
9. Foreign Investment Review Board (FIRB)
10. Future of BTR: Opportunities and Challenges



What is BTR?

- Historically ‘build to own’
- Shift to long-term renting

- **Definition:** Design and construction of apartment complexes for the purpose of being owned, managed and operated by an institutional investor as a long-term investment. However, there are trends towards single family dwellings

- Typically, 300-400 apartments per project
- Accelerated supply to the market



There is a ‘realistic prospect’ of establishing build-to-rent real estate as a ‘significant new investment asset class’

Housing Minister, Julie Collins



BTR Sector – Australia

Housing Affordability Crisis:

- National vacancy rates lowest on record
- Supply is inadequate in meeting demand
- A fall in production of investment properties

Potential Solution?

- A sustainable long-term delivery model (BTR) which, with the right incentives, will contribute to a functional and diverse housing market

Current state of play – BTR:

- BTR sector in Australia is valued at AU\$16.87 billion
- Most BTR projects are predicted to commence construction in 2026
- 2023 = 1,488 BTR apartments under construction

BTR Sector – Global

United Kingdom

- Population (as of 2023) – approx. 68 million
- 266,992 BTR homes complete, under construction, or in planning (Q4 2023)
- Post-GFC boom
- Key events:
 - Montague Review (2012)
 - Build to Rent Fund (2012/13)
- An example for Australia to follow

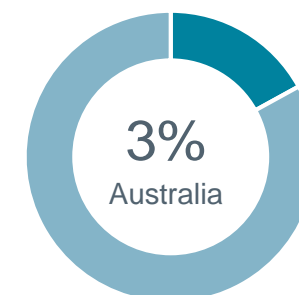
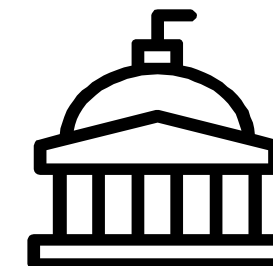
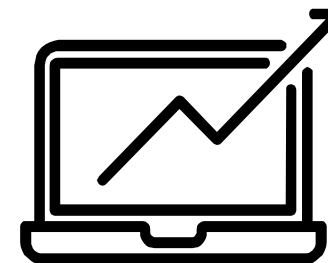
United States

- Population (as of 2023) – approx. 340 million
- 2023 – annual completions reached 416,500
- 2023 – annual BTR investment reached AU\$117.5 billion

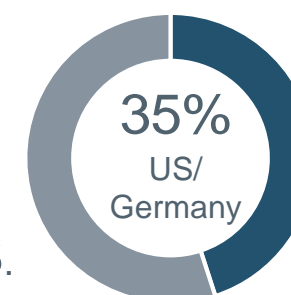


BTR – Investors and Government Institutions

- The choice to invest in BTR assets brings with it a number of benefits for an **investor**:
 1. Stable returns;
 2. Low income volatility; and
 3. Diversified income stream.
- For Australian **government institutions**:
 1. Longer-term budgetary savings;
 2. Tangible reductions in homelessness; and
 3. Opportunity to provide economic impacts in the community.
- **Australia is behind:**
 - Largely due to tax impediments and planning regimes.



VS.



Tax Impediments – GST, Transfer Duty and Land Tax

The additional tax implications of BTR projects are threefold and consist of GST, Transfer Duty and Land Tax.



1. GST

- GST leakage
- Commercial residential premises
- **Potential solution?**
 - Permit a developer to claim back full input tax credits when land acquisition and development costs are incurred.



2. Transfer duty

- Transfer duty is enforced by all Australian states and territories
- **Considerations:**
 - Purchase at lowest market value;
 - GST-free supply of a going concern;
 - Duty risks from securing a site via a call option;
 - Duty risks when land is transferred to another entity on completion of purchase; and
 - Transfer duty and heads of agreement.



3. Land tax

- Enforced by all Australian states and territories except NT
- Cannot be defrayed like traditional commercial real estate assets or lower-scale residential property investors

Benefits of Residential Tenancy

BTR is an exhaustive solution to a residential market imbalance → highlights the inadequacies of the Government's 'Band-Aid solutions'.

- Legislation to prohibit real estate agents from soliciting rent bidding for residential properties
- One-year limit on the number of rental increases for residential rental properties
- Over focused on affordable and social housing, rather than increasing general housing supply



Affordability and tenure security

Home ownership is increasingly unaffordable and new housing supply comes to a halt



High quality assets

Improved amenities and well-maintained dwellings.

The amenities foster a **sense of community**



Added flexibility

Offer tenants the opportunity to move between accommodation options, customise apartments and scale up or down within the complex



Convenience

Located in highly sought after locations.

Greater access to education and employment opportunities



Professionally-managed properties

On-site management and operating teams with repairs and maintenance requests managed by on-site staff

Social and Affordable Housing Initiatives



Affordable Rental Housing
(includes essential/key worker
housing)

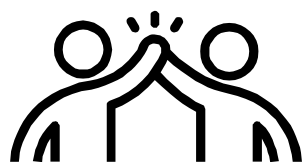
- Private rental property that is priced to support individuals on low to moderate incomes.
- Key worker - allows essential service workers to live close to their employment

Social Housing

- Includes crisis and public housing

Affordable Housing Initiatives and BTR

- Government subsidies and financial incentives
- Tax-related incentives
- Housing Australia – concessional finance options to BTR developers



- Australian superannuation funds entering BTR projects:
 - Aware Super → 11-asset portfolio worth AU\$7 billion and AU\$800 million to develop Key Worker Affordable Housing assets
 - AustralianSuper → AU\$920 million development of 1092 BTR units
 - Super Housing Partnerships → AU\$240 million fund for BTR and access to equity investment in BTR with a focus on Social and Affordable Housing



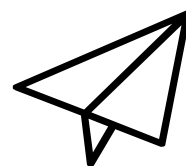
Affordable Housing – Global Incentives

- Tax credits
- Grants
- Low-interest loans to developers for low-income housing

US

- Affordable Homes Guarantee Scheme
- Financial incentives i.e. grants and tax breaks
- Section 106 agreements

UK



Affordable Housing – Challenges

- Obstacles:
 - Defining ‘affordable housing’
 - Establishing criteria for who requires access to affordable housing
 - Changes in Government/discontinued policies and programs
 - BTR projects being taxed at the same rate as other asset classes
 - Zoning and associated land use regulation
 - Duplication in services
 - Obtaining the requisite capital to fund affordable housing



Question to consider: Is social and affordable housing adequate to cure the housing crisis? Should there be broader incentives to increase general housing supply thereby responding to normal demand/supply curves?

BTR and Sustainability – BTR as an Opportunity for Energy Efficiency

- “Once-in-a-generation” changes
- Supply-side versus **demand-side (energy efficiency)**
- “Hidden fuel”:
 - Reducing a building's electricity or gas and water usage
 - Waste management
 - Regenerating indoor environments
- Mass timber as a sustainable alternative to concrete in Australia’s BTR sector
- Capital needs to be more proactive
- ESG target driven investors

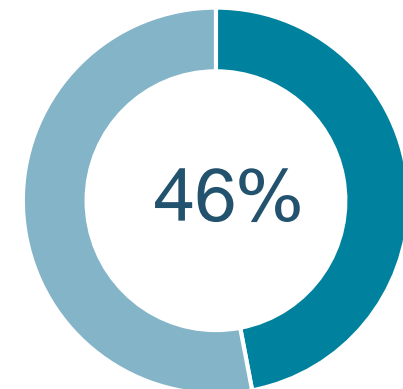


Energy efficiency has been called a ‘hidden fuel’ yet it is hiding in plain sight...is energy efficiency not just a hidden fuel but rather the world’s first fuel?

IEA Executive Director, Maria van der Hoeven



The Ballarat GovHub achieved a



Reduction in upfront carbon by using mass timber.

Debt funding – Housing Australia (HA) and Housing Australia Future Fund (HAFF)

- Housing Australia (HA) provides funding to developers to support the BTR initiative
- Previously National Housing Finance and Investment Corporation (NHFIC)
- HA's funding options:
 - Home Guarantee Scheme
 - Affordable Housing Bond Aggregator
 - National Housing Infrastructure Facility
 - Housing Australia Future Fund Facility
 - National Accord Facility

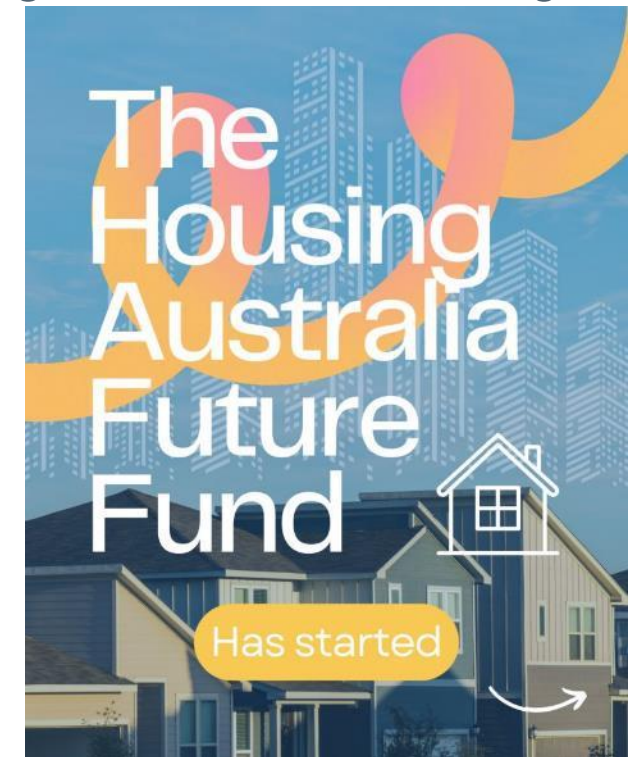


- HAFF package:
 - AU\$10 billion – 30,000 new social and affordable homes in five years
 - AU\$1 billion – National Housing Infrastructure Facility
- National Housing Accord:
 - Concerns on meeting July 2029 target
 - Department of Planning estimates only 11,400 of the 38,000 homes will be built during the first five years

Housing Australia Future Fund (HAFF) – How Does it Work?

- Funding rounds across 5 years
- Assess applications in accordance with the Investment Mandate Direction
- Each successful applicant will enter into a Framework Funding Agreement with Housing Australia

Applications are open until 22 March 2024 2:00pm for the first funding round



Housing Australia Future Fund – Eligibility Criteria

The following entities are eligible to apply:

- CHPs that are registered under the National Regulatory System for Community Housing and are registered charities
- Australian States and Territories, local governing bodies and government-owned corporations
- Charitable entities
- SPVs whose purpose is to increase social and/or affordable housing

The following projects are eligible to be funded if:

- All dwellings proposed to be designed, constructed or made available under the project are wholly located in a particular State or Territory
- The project increases available social housing and/or affordable housing
- Projects lodged on or after 1 October 2023 must be HAFF/NHAF construction compliant

Housing Australia Future Fund – Updated Funding Documents and Clarification Areas

- HA will be rolling out a number of key funding documents
- HA has provided further guidance on a number of key areas:

Project Completion

Projects need to be built or ready to commence within 18 months and fit the funding parameters

Discretion on Financing Stack Composition

HA has confirmed their discretion surrounding financing stack composition

Portfolio Project Applications

HA has reinforced that the call for applications includes portfolio project applications

Group Project Debt Tenor

HA will seek to group project debt tenor

Security

HA will soon release legal documents to provide clarity on requirements around security

Clarification on Terms

HA will provide further clarification on the terms 'construction commencement' and 'regional areas'

Tax Exemptions and Incentives – Accelerated Depreciation

The second incentive...

Accelerated Depreciation

The Australian Government has also announced accelerated capital works deductions allowed for eligible BTR projects, by allowing capital works to be depreciated at 4% (up from 2.5%) per year (or over 25 years instead of 40 years)

- Critical to the economic success of BTR projects

Eligibility criteria (subject to future consultation and detail)

Construction must have commenced after 9 May 2023 (Budget night).

BTR project must consist of 50 or more apartments or dwellings.

Those apartments or dwellings are made available for rent to the general public and retained under single ownership for a minimum of 10 years before being sold.

The landlords must offer a lease term of at least three years for each apartment or dwelling.

Tax Exemptions and Incentives – BTR Concessions

- NSW, VIC, SA, QLD and WA each offer some form of exemption or ex gratia relief – varies between each jurisdiction
- Qualifying BTR projects → exemptions from surcharge purchaser duty, surcharge land tax and a 50% reduction in the value of the land for up to 20 years

Drawbacks

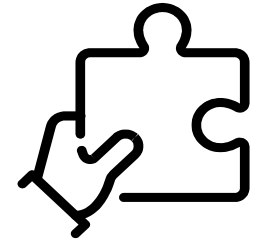
- Lack of harmonisation across jurisdictions
- As some jurisdictions require applicants to seek discretionary ex gratia relief, this does not provide the same level of certainty as a legislated exemption or concession

Tax Exemptions and Incentives – Charities

- Potential GST and transfer duty tax incentives



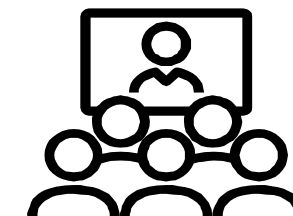
A government creating a housing scheme does not necessarily mean that providing housing under the scheme is considered 'charitable' under the *Charities Act 2013* (Cth)
Statement made by Australian Charities and Not-for-profits Commission



- This could be an issue for registered CHPs that are proposing to establish SPVs as charities to undertake affordable housing projects
- **Potential solution** → an upfront legal review of the relevant entity's constitution and charitable objects within the constitution

Foreign Investment Review Board (FIRB)

- FIRB approval is required:
 1. Acquisitions of vacant commercial land and vacant residential land **for a BTR project**
 2. Acquisitions of developed (non-vacant) commercial land where the relevant monetary threshold is met - this may be the case where **office or retail spaces are converted to BTR projects**
 3. The grant, and enforcement of, a security interest over land to foreign persons who have, or are funding, **a BTR project**



Ongoing considerations are:

1. Annual Vacancy Fee

The foreign developer will need to ensure the project is rented out for more than 183 days during a year

2. Register of Foreign Ownership of Australian Assets

Foreign investors should consider whether they must provide notice even if they were not required to obtain FIRB approval



Once notice has been provided, foreign persons will need to provide further notices to the Register if:

1. They cease to hold the legal freehold interest in Australian land;
2. They cease to be a foreign person; or
3. There is a change in the nature of the interest in Australian land

Future of BTR – Opportunities

Investment in new BTR developments to surpass investment in other real estate asset classes

Australia's ageing population

Regenerate existing built form assets by converting them into BTR products

BTR real estate as a **'significant new investment asset class'** with the Australian Government now considering reforms to encourage financing and consulting...to tap into Australia's large pool of superannuation savings
Minister of Housing – Julie Collins

Drive decarbonisation in the built environment

Grocon, Lendlease, Mirvac and Stockland are preparing to enter this new sector

Mum and dad investors

Population growth

Future of BTR – Challenges (Tax)

New thin capitalisation legislation to parliament

'Trading trust' rules

Whether foreign pension fund or sovereign wealth fund investors may be able to access the limited withholding tax exemptions for BTR projects

MIT status and cross-staple income rules

Managing tax on exit for foreign investors

Future of BTR – Additional Challenges

Limited legislative and taxation incentives for institutional investors to enter the market

BTR relies on competition in the debt market

Complex and time-consuming process

Lack of consistent guidelines

BTR assets are relatively new in Australia

Additional security and guarantees may be requested by financiers

Little historical data for BTR assets



Questions



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