



# Impact Analysis

## Reducing the Managed Investment Trust Withholding Tax Rate for Build-to- Rent Developments

24 May 2024

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# Contents

Contents.....	iii
<b>Executive Summary .....</b>	<b>1</b>
<b>Background .....</b>	<b>3</b>
Build-to-Rent (BTR) .....	3
Managed Investment Trust (MIT) .....	4
State and territory BTR initiatives .....	5
<b>The problem.....</b>	<b>5</b>
The need for well-located affordable rental supply.....	7
<b>Case for government action/objective of reform.....</b>	<b>8</b>
<b>Policy options .....</b>	<b>9</b>
Option 1: Maintain the Status Quo .....	11
Identification of viable alternative policy options .....	<b>Error! Bookmark not defined.</b>
Option 2: Reduce the MIT withholding tax rate in line with other comparable asset classes and require a portion of dwellings to be offered on a discounted basis.....	<b>Error! Bookmark not defined.</b>
Option 3: Reduce the MIT withholding tax rate in line with other comparable asset classes and require a portion of dwellings to be offered as affordable tenancies.....	13
<b>Cost benefit analysis of each option .....</b>	<b>14</b>
Option 1: Maintain the status quo .....	14
Reducing the MIT withholding tax rate to be in line with other comparable asset classes.....	15
Impacts on the Government .....	15
Impacts on BTR investors .....	16
Impacts on society .....	17
Impacts to other property investments .....	18
Option 2: Reduce the MIT withholding tax rate in line with other comparable asset classes and require a portion of dwellings to be offered as affordable tenancies.....	18
Option 3: Reduce the MIT withholding tax rate in line with other comparable asset classes and require a portion of dwellings to be offered as affordable tenancies and restrict eligibility for affordable tenancies.....	19
<b>Consultation plan .....</b>	<b>21</b>
2023-24 Budget announcement .....	21
Targeted consultations .....	21
Public consultation on Exposure Draft.....	21
Stakeholder views .....	21
Affordable dwellings.....	22
Existing BTR developments .....	23
Single ownership retention period .....	23
Misuse tax .....	24

Option selection and implementation .....	24
Evaluation and review .....	26
Appendix 1: Status of the IA at each major decision point.....	28

## Executive Summary

Australia is facing housing supply pressures which have pushed up house prices and market rents and created affordability issues for households. Housing supply challenges need to be addressed to ensure Australians have access to better housing choices that are safe, stable and affordable.

There are a range of policy approaches that could help ease housing pressures but there is no single solution. The Government is implementing a number of measures to address Australia's housing challenges, including to support additional housing supply, and a focus on helping those most in need.

The policy outlined in this Impact Analysis focuses on the use of taxation levers to support an increase in the supply of residential housing, including affordable housing, in good locations in the rental sector – by attracting more institutional investment.

Given the relative undersupply of Build-to-Rent (BTR) housing in Australia compared to other countries, the Government announced, in the 2023 –24 Budget, that it would introduce tax incentives to encourage foreign investment and construction in the sector to help improve rental housing supply. BTR properties will typically be located close to jobs, transport and other amenities. Reflecting the particular concerns about the shortage of affordable housing, the Government indicated it would consult on the inclusion of a minimum affordable housing requirement in these measures.

The announcement included two elements: 1) accelerating tax deductions for the depreciation of BTR assets; and 2) reducing the managed investment trust (MIT) withholding tax rate on income derived from newly constructed BTR assets. [Appendix 1](#) outlines the status of this Impact Analysis at each major decision point.

MITs are a type of investment vehicle that is widely used by foreign investors to invest in passive income-generating assets in Australia. Reducing the MIT withholding tax rate has been used by governments in the past to attract foreign investment in other property-related sectors including energy-efficient commercial buildings and affordable housing.

The Office of Impact Analysis has assessed that accelerating tax deductions for depreciation of BTR assets will likely to have a minor regulatory impact. Therefore, this Impact Analysis will only consider the impacts on reducing the MIT withholding tax rate.

This policy would support an increase in residential housing supply, with an emphasis on rental stock and affordable housing, in good locations by providing tax concessions to attract more foreign institutional investment to the Australian BTR sector.

The Impact Analysis assesses three options including the status quo. A summary of options, merits and risks is summarised below.

Options	Merits	Risks
Option 1 – maintain the status quo	Option 1 would not incur any government fiscal cost but would maintain the current low growth of the BTR sector. Existing constructions and limited planning for new BTR projects may proceed.	<p>The current 30 per cent withholding tax rate for BTR projects means after-tax rates of return are uncompetitive compared to other asset classes such as commercial buildings which are subject to a 15 per cent rate. As a result, investment in the BTR sector is likely to stagnate.</p> <p>The shortfall in housing supply, including affordable housing in good locations, will persist imposing a social cost.</p>

<p>Option 2 – reduce the MIT withholding tax rate in line with other comparable asset classes and require a portion of dwellings to be offered on a discounted basis</p>	<p>Option 2 would help to establish a build to rent sector, boosting housing supply both directly through increased foreign investment and indirectly attract domestic investment in the medium to long-term.</p> <p>Option 2 would provide tenants with longer-term tenancies, ancillary services, efficient maintenance and other benefits typically provided by BTR developments.</p> <p>Option 2 would also require a portion of dwellings to be offered at a discount to market rent, which may improve affordable housing supply, including for essential workers, to the benefit of the broader community.</p>	<p>The lack of eligibility requirements to determine which tenants would be offered the discounted dwellings may create uncertainty around the distribution of the discounted dwellings, and the benefits for these dwellings.</p>
<p>Option 3 – reduce the MIT withholding tax rate in line with other comparable asset classes, require a portion of dwellings to be offered on a discounted basis, and limit eligibility for the discounted dwellings.</p>	<p>Option 3 would also help to establish a build to rent sector, boosting housing supply and providing tenants with a range of benefits.</p> <p>In addition to Option 2, Option 3 would include maximum income or asset conditions for BTR operators to select who is eligible to apply for discounted dwellings. This option will ensure high income households are excluded from accessing the affordable dwellings.</p> <p>Option 3 would therefore more directly and with greater certainty assist key workers to find affordable dwellings in well-located areas, to the benefit of the broader community.</p>	<p>Option 3 introduces requirements for affordable dwellings which would lead to increased management costs for investors. This could reduce the rate of returns for foreign investors and reduce the attractiveness of the tax incentive.</p>

Options 2 and 3 will reduce the withholding tax for foreign investors that invest in the BTR sector. It is expected that Options 2 and 3 would provide an increase in housing supply with a net benefit compared to the status quo. Both options would help to establish a BTR sector in Australia, which can be expected to deliver housing supply beyond the level directly supported by the policy by attracting additional investors into BTR, such as domestic institutional investors. Attracting institutional investment will support the housing market to provide more diverse private housing, reducing the demand for further direct government investment in housing through programs like the Housing Australia Future Fund (HAFF). This will help to meet Australia’s housing needs at a lower fiscal cost.

Option 2 is expected to impose a smaller regulatory burden compared to Option 3 as no allocation requirements are imposed on the BTR development owners in relation to the discounted dwellings. However, the impact of the affordable housing supply provided by Option 2 is unclear as there is no guarantee that the discounted dwellings would benefit an appropriate cohort of tenants.

Option 3 would ensure the benefit flows through to key workers to help fulfill their need for affordable housing in good locations. For example, it would assist nurses in being able to live closer to the hospitals they work in. Increasing housing supply and affordability in well-located areas can positively affect productivity. Therefore, the increased regulatory burden in Option 3 to limit eligibility for the discounted dwellings to ensure appropriate targeting of the affordable housing would help guarantee additional benefits.

Considering the costs and benefits, Option 3 has been identified as the preferred option with the highest net benefit for Australia. Option 3 is the preferred option to achieve an increase in rental housing supply combined with an increase in affordable rental housing for more moderate income earners.

# Background

On 28 April 2023, National Cabinet agreed to a comprehensive package of reforms that recognise the housing challenges faced by all levels of government to support a national approach to the growth of Australia's cities, towns and suburbs.

As part of this package, the Government announced it would increase the supply of housing by offering incentives to eligible new BTR projects. Further detail on that commitment was provided in the 2023-24 Budget through the measure 'Housing (Build-To-Rent Developments) – accelerating tax deductions and reducing managed investment trust withholding tax rate', which is intended to encourage investment and construction in the BTR sector and expand Australia's housing supply. The measure noted that consultation will be undertaken on implementation details, including a requirement to have a minimum affordable housing component.

## Build-to-Rent (BTR)

BTR housing refers to large scale, multi-unit developments where residential dwellings are retained by one owner/entity and rented out to tenants as a long-term revenue generating asset. Developments are typically purpose built, institutionally owned and professionally managed. This contrasts with build-to-sell developments where the decision on whether the dwelling is available for rent or is occupied by the owner is a decision for the owner of that individual dwelling.

BTR, being higher density constructions, are also typically located close to jobs, transport and other amenities. Having homes in good locations improves liveability, productivity and better utilises infrastructure; having affordable housing in those same locations will allow essential workers to live in the communities in which they work and provide essential services.

BTR housing also provides tenants with a number of benefits that are not widely available for tenants of properties owned by individual landlords.

- The long-term investment period provides tenants with access to long and stable leases, allowing them to build long-term connections to the local community. This will benefit more Australians who are now renting longer before entering homeownership or renting on a more long-term, permanent basis.
- BTR property managers are responsible for the entire development, which can streamline building maintenance and repairs to a higher standard. Additionally, since BTR developments have long investment horizons, building owners have a financial incentive to construct better quality housing and carry out ongoing maintenance.
- Single ownership of the entire building allows for high quality amenities and services for tenants (such as on-site concierge, communal spaces and social events).

Australia's BTR sector is currently very small, with only around 11 developments in operation as at February 2023.<sup>1</sup>

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<sup>1</sup> Ernst & Young, [A new form of housing supply for Australia: build-to-rent housing report](#), 4 April 2023, p 22.

## Managed Investment Trust (MIT)

A MIT is a widely-held collective investment vehicle in which members of the public and/or institutional investors invest to derive passive income, such as dividends, rent or interest. MITs must meet certain requirements to be eligible for concessional tax treatment.

Trustees, custodians, and other entities are required to withhold amounts of withholding tax from certain fund payments made to non-resident investors and remit that tax to the Australian Taxation Office (ATO). A fund payment is a payment made by a MIT trustee to investors out of the Australian sourced net income, including capital gains, derived by the trust and the withholding tax represents a final tax on those earnings for the non-resident.

The rate of tax to 4 withheld will vary according to whether the investor is a resident of a country that has an exchange of information agreement with Australia, and the type of income the fund payment is attributable to. For fund payments that do not include dividends, interest or royalties, the relevant withholding tax rates applicable to an investor from an information exchange country are:

- the ‘non-concessional’ withholding tax rate of 30 per cent, applied to agricultural property, trading income, cross-staple income and most residential income, since 2019;
- a ‘concessional’ rate of 15 per cent which has applied to eligible commercial property since 2012, and affordable housing since 2019; and
- a ‘concessional’ rate of 10 per cent, which has applied to a limited range of newly constructed ‘clean’ (energy efficient) commercial buildings since 2012.

The withholding tax rate for investors from non-information exchange countries is 30 per cent.

Payments of dividends, interest or royalties to foreign residents are subject to different withholding tax arrangements.

The table below outlines the applicable withholding tax rate for income derived from BTR and other comparable assets for investors from information exchange countries.

Residential housing – BTR	Residential housing – Affordable	Commercial property	Commercial residential premises	Clean building commercial property
30 per cent	15 per cent	15 per cent	15 per cent	10 per cent

The 30 per cent withholding tax rate for distributions of income, including capital gains, derived from BTR assets is higher than for other comparable assets such as hotels, offices and affordable housing, but is broadly consistent with the corporate tax rate of 30 per cent. There is, however, also a range of other factors considered in an investment decision between property classes, such as relative risks and investor mandates around environmental, social and governance (ESG) considerations.

Additionally, differences in the Australian and overseas tax treatments can make Australian investments less competitive for foreign pension funds, a significant source of global investment in BTR. Countries such as the United States (US) and Canada do not tax investment returns derived by foreign pension funds: instead, their members are taxed when they withdraw their pension. In contrast, foreign pension funds that invest in Australian MITs (whether they invest in BTR or otherwise) are subject to double taxation at both the fund and member level. For example, a Canadian pension fund does not pay any tax on income from a BTR project in the US but would be subject to Australia’s 30 per cent withholding tax on income from an Australian BTR investment through a MIT, and its members would be subject to Canadian taxes on withdrawal of their pensions.



## State and territory BTR initiatives

Several states and territories have already introduced concessions to support investment in BTR housing. New South Wales, Victoria, South Australia, Western Australia and Queensland have all introduced a 50 per cent concession on land tax for BTR projects. Some states have also introduced concessions on foreign investor duties and surcharges. Queensland and the Australian Capital Territory's BTR concessions require a portion of dwellings of the BTR project to be affordable housing.

States and territories have different approaches to defining the term 'affordable housing', for their BTR tax concessions or for planning regulation purposes. Generally, they define affordable housing as housing appropriate for households on very low, low or moderate incomes. These household types are further defined by reference to average or median earnings as reported by the Australian Bureau of Statistics, as well as by household composition. For example, households with more than one adult and with dependents are able to meet the definition of very low, low or moderate income with higher income limits than a single adult.

## The problem

*Australia is facing a shortage of housing relative to demand, especially in good locations, which is weighing on housing affordability and contributing to rental stress. This proposal addresses one particular facet of this problem: the lack of institutional investment in Australian BTR and the need to attract foreign institutional investors who are familiar with BTR as an asset class. Once established as an asset class this will help to build scale and liquidity in the sector and thus attract domestic investors. However, foreign investors are not currently investing in BTR due the current tax settings being uncompetitive relative to other property investments in Australia and the treatment of BTR investments in other jurisdictions.*

Australia is experiencing significant housing challenges, with housing supply not keeping pace with the growth in demand. The National Housing Supply and Affordability Council (NHSAC) reported in 2024 that Australia is experiencing insufficient supply, with rental vacancies at an all-time low of 1.6 per cent (well below a rate associated with a balanced market of 3-4 per cent).<sup>2</sup>

New housing supply is weakening as higher interest rates and increased material and labour costs dampen construction. Treasury analysis suggests dwelling investment contracted by 3.8 per cent in 2022-23 as elevated construction costs and labour and material constraints weighed on activity. Dwelling investment is expected to contract further in 2023-24, reflecting the current weak level of building approvals, before picking up moderately in 2024-25.

Low completions and approvals partly reflect challenges in achieving investment returns in new housing projects. There also continues to be a backlog of new homes under construction, with 222,000 private residential dwelling units incomplete as at the December quarter 2023 (around 30 per cent above the pre-2020 average).<sup>3</sup>

Compounding this weak supply is the increase in population following the re-opening of borders in 2022 after the pandemic which adds to housing demand.<sup>4</sup>

The shortage of housing is a key factor leading to prices and rents growing faster than wages. Rents have increased by around 35 per cent since the start of the decade.<sup>5</sup> The number of households that lack access to appropriate housing at rents that do not lead to financial stress is growing.

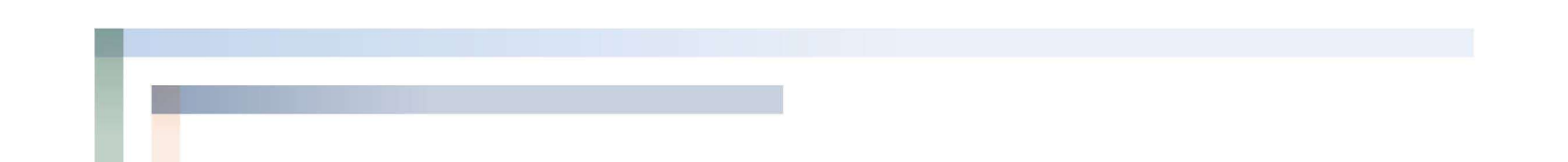
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<sup>2</sup> National Housing Supply and Affordability Council, *State of the Housing System 2024*, May 2024, p 1

<sup>3</sup> NHSAC, *State of the Housing System 2024*, p 66

<sup>4</sup> NHSAC, *State of the Housing System 2024*, p 74

<sup>5</sup> NHSAC, *State of the Housing System 2024*, p 3



A deterioration of housing affordability also increases demand for non-market housing, such as affordable housing. Within the overall housing market, there is a particular lack of affordable, safe, secure and well-located housing for many Australians on low and more moderate incomes. The Australian Housing and Urban Research Institute estimated in 2023 that to satisfy current unmet and projected future demand for social and affordable housing, an additional 942,000 social and affordable dwellings will need to be constructed by 2041.<sup>6</sup>

NHSAC research shows workers are also living an increasingly further distance from their place of work, associating this with a lack of affordable housing in cities.<sup>7</sup> As discussed in Statement 4 (Meeting Australia's Housing Challenge) in Budget Paper No. 1, Budget 2024-25, increasing housing supply and affordability in well-located areas can positively affect wages and productivity. It can also assist with essential workers living in the community in which they work and support.

Currently, the vast majority of rental housing in Australia is provided by individual landlords, with institutional investors having a limited role. In September 2023, NHSAC released its report *Barriers to Institutional Investment, Finance and Innovation in Housing*, which identified a role for institutional investment in increasing rental housing supply through BTR developments. The Report found such investment would improve affordability and ease rental shortages.<sup>8</sup> Similar findings were made in Housing Australia's *State of the Nations Report*.<sup>9</sup>

The report also identified several barriers relevant to investing in BTR that should be addressed at the federal level:

- inadequate risk-adjusted returns;
- lack of an existing market, scale and performance history; and
- policy and regulatory uncertainty and complexity.

The 2023 Senate inquiry into the *'The worsening rental crises in Australia'* heard that larger scale investment by institutional investors in the BTR sector would expand the supply of rental housing, including affordable housing. This would also help in mitigating the impact on rental prices of short-term interest rate increases, which can potentially be better borne by large scale institutions compared to individual investors. In addition, some submissions noted that a larger BTR sector could increase tenure security.<sup>10</sup> Other benefits that are not widely available for tenants of properties which are owned by individual landlords, include proximity to central business districts (and hence employment opportunities), standardised repair and maintenance, and better communal facilities.

Australia has a very small BTR sector compared to countries such as the US and United Kingdom (UK). In those jurisdictions, BTR investments are popular among large institutional investors with long time horizons, such as pension funds. Australia is not seen as an attractive option for foreign investment due to our high rates of taxation on BTR compared with other jurisdictions and other property investment classes, such as commercial property.

Foreign investors currently have the greatest familiarity with this sector and so the best capacity to build at scale and induce participation of domestic institutional investors or to partner with domestic institutional investors. Australian superannuation funds – the largest cohort of domestic institutional investors – are hesitant to invest in BTR despite facing a 15 per cent tax rate due to insufficient scale and relative inexperience in this emerging sector.<sup>11</sup> The net benefit of incentivising foreign investment

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6 Martin et al., [Towards an Australian Housing and Homelessness Strategy: understanding national approaches in contemporary policy](#), AHURI, 15 June 2023, p 60.


7 National Housing Supply and Affordability Council (2024), "State of the Housing System" 2024, p.35-37

8 National Housing Supply and Affordability Council, [Barriers to Institutional Investment, Finance and Innovation in Housing](#), July 2023, p 15.

9 Housing Australia, [State of the Nation's Housing Report 2022–23](#), p 52.

10 The Senate, [The worsening rental crisis in Australia](#), December 2023, p 30-31

11 NHSAC, [Barriers to Institutional Investment, Finance and Innovation in Housing](#), p 20.



would likely exceed the number of dwellings directly built as a result of that investment. In the longer term it could attract a broader range of investors, including domestic institutions, into the sector by helping to demonstrate the viability of a mature BTR market in Australia.

## The need for well-located affordable rental supply

BTR housing brings the economic benefit of increasing housing supply in a cost-effective and efficient manner. BTR housing is generally developed in places with the most unmet excess demand. The NSW Productivity Commission found that where infrastructure costs were the lowest was where people most wanted to live.<sup>12</sup> In the Sydney context this included areas such as the central business district and parts of the lower north shore, eastern suburbs and the inner west.

The UNSW City Futures Research Centre finds that while land prices in inner city areas are higher, there is less of a need to develop infrastructure. Construction costs in infill areas are lower than greenfield areas, as is the cost of provision of electrical, water and sewage, telecommunication and gas. The cost of social infrastructure such as fire, ambulance, police and education is also lower. Affordable units, in higher densities, would be therefore associated with lower construction costs and per unit land values.<sup>13</sup>

Furthermore, the cost of servicing new housing with infrastructure varies between inner and outer suburbs. Inner suburbs have lower costs due to short commutes, more active and public transport options, more water related infrastructure, greater economies of scale as well as school capacity.<sup>14</sup> For example, Sydney infrastructure generally costs around \$39,000 per property less than in greenfield areas.<sup>15</sup>

Similarly, the Centre for Independent Studies referred to research by AECOM that found in Canberra, it costs \$68,600 per new dwelling to provide infrastructure in the most costly locations (the greenfield suburb of Whitlam), but \$9,000 or less in inner suburbs where existing infrastructure had excess capacity.<sup>16</sup>

An additional economic benefit of BTR housing, being built in inner-city areas is that it has a broader positive impact on housing affordability. Increasing supply in high value, in demand areas improves affordability for households who cannot live there. This is because as higher income households move into newer, well-located housing it frees up space in nearby suburbs that they previously resided in. This process (known as ‘filtering’) flows through the income distribution so that lower-to middle income families have increased opportunities to move closer to inner urban areas.

In Australian cities, higher paying jobs in knowledge and service industries have historically been located in central areas, which are close to public transport. Housing located in these areas is more expensive, and lower paid workers employed in central city areas will face affordability burdens and long commutes<sup>17</sup>. This can lead to reduced participation in the labour market. AHURI reports that long commuting impacts productivity, including through absenteeism as well as employee performance.<sup>18</sup> Households may also be unable to sustain housing stress in the long term, leading to greater staff turnover and recruitment challenges and reduced labour market participation, also lowering urban

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12 2023, NSW Productivity Commission, Building more homes where infrastructure costs less, p 7

13 2019, UNSW City Futures Research Centre, Strengthening Economic Cases for Housing Policies, p 22

14 2023, NSW Productivity Commission, Building more homes where infrastructure costs less, p 8

15 2023, NSW Productivity Commission, Building more homes where infrastructure costs less, p 11

16 2023, Centre for Independent Studies, Where should we build more housing, p 17

17 2021, AHURI, Urban productivity and affordable rental housing supply in Australian cities and regions, p 28

18 2021, AHURI, Urban productivity and affordable rental housing supply in Australian cities and regions, p 12

productivity. Therefore, increased availability of affordable accommodation from BTR housing promotes workers and employers' access to the labour market, increasing productivity.<sup>19</sup>

Research published by Australian Housing and Urban Research Institute (AHURI) finds that 20 per cent of key workers across Sydney and 17 per cent across Melbourne are struggling to find appropriate and affordable housings, with much higher rates in inner subregions. Further, key workers are more likely than the labour force generally to reside in outer suburbs and satellite cities and to commute more than 30 kms to work.<sup>20</sup>

Research from EY, commissioned by Aware Super, suggests essential worker housing affordability crisis is costing Australia around \$64 billion. Their modelling found providing affordable housing for essential workers such as nurses, teachers and police officers generates an additional \$45,500 per tenant per annum in benefits shared across the economy.<sup>21</sup>

## Case for government action/objective of reform

*This proposal addresses the lack of investment in Australian BTR due to current tax settings for foreign institutional investors being uncompetitive relative to other property investments in Australia and BTR investments in other jurisdictions. Providing targeted tax concessions to help grow Australia's BTR sector would support the Government's objectives of expanding the housing supply, including affordable housing supply in good locations for those in genuine need, including essential workers. It would also help improve the diversity of Australia's rental accommodation; and make dwellings available with improved features such as security of tenancy, more efficient maintenance, better amenities, and proximity to transport, services and employment. Success would be demonstrated by an increase in the number of BTR dwellings, including affordable dwellings, and the number of investors in the sector, including, over time, domestic institutional investors.*

While land tax concessions have been offered at the state and territory level, high withholding taxes at the Commonwealth level continue to impede investment in the BTR sector by lowering the after-tax return for foreign investors. Only the Commonwealth Government can reduce these applicable withholding tax rates to improve rates of return and induce more investment.

With a Government target of building an additional 1.2 million new well-located homes over 5 years from July 2024, this policy will complement other housing policies addressing Australia's housing supply and affordability challenges. Increases in BTR dwellings, the number of institutional investors active in the industry and development activity will be indicators of a growing asset class supported by the incentive.

Whilst some investment in the Australian BTR sector has occurred, it has been limited compared to other property classes. Moreover, a lack of action will lead to worsening affordability, more households in rental and financial stress and the associated economic and social costs such as homelessness, housing insecurity, lack of employment opportunities and impacts on wellbeing.<sup>22</sup>

Leveraging private capital to support investment in affordable housing can and is increasingly being used by governments operating in a fiscally constrained environment to meet the upfront costs of new affordable housing stock.<sup>23</sup>

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19 2021, AHURI, Urban productivity and affordable rental housing supply in Australian cities and regions, p 28

20 Australian Housing and Urban Research Institute, [Housing key workers: scoping challenges, aspirations, and policy responses for Australian cities](#), May 2021.

21 Aware Super, [Essential worker housing affordability crisis costing Australia \\$64 billion](#), 6 October 2023, accessed 14 May 2024.

22 NHSAC, Barriers to Institutional Investment, Finance and Innovation in Housing, p 1.

23 NHSAC, Barriers to Institutional Investment, Finance and Innovation in Housing, p 17.



Reducing the final withholding tax on BTR projects will make BTR more attractive to foreign institutional investors, helping the Government achieve its target of 1.2 million new homes over 5 years from mid-2024. Furthermore, government intervention can help address the inadequate supply of well-located affordable housing by mandating a portion of BTR dwellings to be offered at a discounted rent for middle-income earners.

NHSAC found that the defining characteristic of institutional investment overseas has been demonstrated commercial viability – including attractive returns and moderate risks. Good quality data on revenues and costs associated with managing properties are also important. Countries with well-established markets also have dedicated and transparent regulatory, legal and tax arrangements for the sector resulting from the development of case law and regulation over time. In addition, overseas markets generally have some form of subsidy that fosters investment, generally in the form of a tax concession targeted at affordable housing or the rental market more broadly. There is no such concession currently legislated for the BTR sector in Australia. Another feature is a well-supplied pipeline of assets suited to institutional investment.<sup>24</sup> As the sector in Australia is in a nascent state, it will need support to become well established.

Whilst public policy could seek to encourage an organic growth of the sector without intervention, it should also consider accelerating the development of the market to generate activity and sustainable growth. This can particularly be achieved through supporting first movers. In fact, NHSAC found that the industry itself has a ‘first mover problem’, where firms are reluctant to enter the market due to perceived disadvantage of early entry. Government action can generally help address the costs of being first movers.<sup>25</sup>

Treasury consulted relevant industry stakeholders on the potential limits, risks and suggestions to improve this policy as part of the policy development procedure. These included continuing inconsistency in regulatory requirements between jurisdictions, as well as the sufficiency of the concession to attract more investment. Industry comments, feedback and suggestions were carefully considered and the proposed legislation was revised to reflect stakeholders’ views where appropriate. The [Consultation Plan](#) below outlines the risk, barriers and limits identified by the industry and reasonings on Treasury’s action.

## Identification of viable alternative policy options

The NHSAC’s *State of the Housing System 2024* report states that market supply of housing is inadequate and that this in part reflects the challenges associated with achieving adequate investment returns.<sup>26</sup> As such, the responsiveness of supply to demand is influenced by the broader economic environment, including the cash rate, mortgage rates, the cost of building materials and consumer inflation, and levels of disposable income. The ability of the market to respond to demand by providing additional stock is influenced by a number of factors including taxes, lending regulations, land prices, land availability, housing market regulations and grants.<sup>27</sup> It is unreasonable to expect that in the absence of Government action the industry will find ways to achieve target returns and supply more housing. As such, Government action is necessary to support the industry.

Whilst Government can choose to target a number of these factors, EY reports that for BTR housing, the 30 per cent MIT withholding tax rate causes lower after-tax returns which do not support investment hurdles and that a 15 per cent rate would be comparable to the rates charged in the US

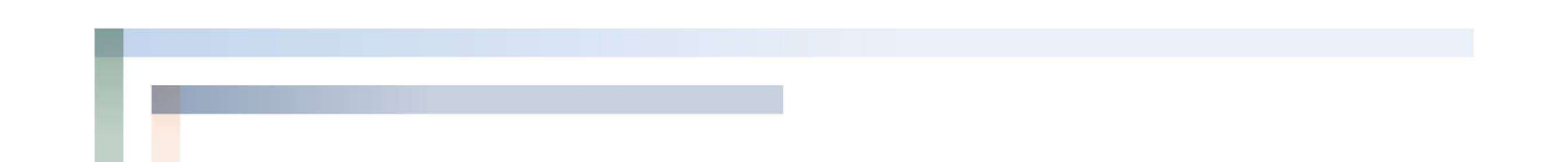
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<sup>24</sup> NHSAC, *Barriers to Institutional Investment, Finance and Innovation in Housing*, p 27

<sup>25</sup> NHSAC, *Barriers to Institutional Investment, Finance and Innovation in Housing*, p 53

<sup>26</sup> NHSAC, *State of the Housing System 2024*, p 66.

<sup>27</sup> NHSAC, *State of the Housing System 2024*, p 83



and UK markets on their Real Estate Investment Trust Regime. Furthermore, 80 per cent of the investment in Australian BTR thus far has been foreign capital by institutional investors<sup>28</sup>. It is therefore appropriate to consider MIT tax settings as the key mechanism by which the Government can impact investor returns and encourage further investment.

The Commonwealth is working with state and territory governments to reform planning laws and improve the delivery of housing. Nonetheless, adjusting tax settings for BTR can directly incentivise the asset class while other reforms are progressed.

Reducing the MIT withholding tax rate on BTR will not, by itself, achieve the policy objective of increasing the supply of affordable housing. The majority of current BTR dwellings attract premium rents and are unlikely to be categorised as affordable.

## Policy options

The Government has an extensive range of policies to address the housing challenges outlined earlier. These have been comprehensively set out in Budget Paper No. 1 (Statement 4: Meeting Australia's Housing Challenge) in Budget 2024-25. State and Territory governments are also taking action to improve housing supply, including reducing costs of building homes.

Acknowledging all the measures governments at all levels are undertaking, this policy looks at how the Australian Government can use targeted tax concessions to reduce entry costs for institutional investors, to encourage growth in BTR as a new housing asset class and increase the participation (and capital) of such investors in the housing market, whilst ensuring that essential workers are better able access BTR tenancies. More BTR properties can also increase housing security for tenants, complementing other government actions to improve the rights of tenants discussed in Statement 4 in Budget Paper No. 1, Budget 2024-25.

The targeted tax concession announced in the 2023-24 Budget is a reduction in the withholding tax rate (from 30 per cent to 15 per cent) that applies to MIT distributions made to foreign institutional investors. Typically, such distributions would comprise both rental income and capital gains attributable to BTR activities.

Noting the long-term nature of BTR, eligibility for the concession will require the continuous operation of a development as a BTR development for minimum period. The Government initially indicated it would consult on a minimum period of at least 10 years. Targeted consultation with industry participants suggested a period of at least 15 years would be appropriate. This acknowledges the long-term nature of such projects and is consistent with rules that apply in NSW, Victoria and Western Australia in relation to eligibility for state government BTR tax concessions.

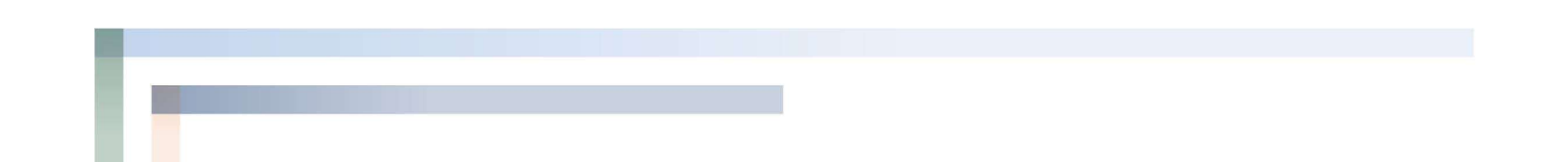
### Protecting the integrity of the tax concession

Integrity rules are common in tax law, particularly in relation to tax concessions, to discourage and penalise non-compliance. This is necessary to ensure the tax concessions achieve their objectives.

The exposure draft legislation contained a BTR misuse tax designed to neutralise the tax concessions provided to a BTR development that became non-compliant during the 15-year BTR compliance period. The misuse tax aims to compensate the Government for the tax benefit incorrectly enjoyed by taxpayers during the entire compliance period. This reduces any incentive for BTR operators to stop complying with the rules part way through the 15-year period, such as by selling off apartments to individual owners or ceasing to provide affordable housing. Without the misuse tax, the profits from such activity could outweigh the loss of future MIT WHT concessions on complying BTR income. This

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<sup>28</sup> Ernst & Young, A new form of housing supply for Australia: build-to-rent housing report, p 28.



approach is consistent with that taken by NSW and Victoria in relation to state BTR land tax concessions.

‘Safe harbour’ rules were inserted into the final legislation to provide the Commissioner of Taxation with the discretion to disregard temporary periods of ineligibility that were outside the control of the owner of the BTR project. This should ensure that the BTR misuse tax will only be applied to more egregious breaches.

The BTR misuse tax would be a feature of both Option 2 and Option 3.

## Policy options deemed non-viable

Providing tax concessions to domestic investors has not been considered as an option within the scope of this policy. Domestic investments in BTR and other residential houses (such as build-to-sell) are subject to the same tax treatment. While introducing tax concessions for domestic investments in BTR could improve returns for these investors, there is a risk that domestic investors would just refocus from constructing build-to-sell houses to BTR, which would not increase the total rental housing supply while forgoing government tax revenue. Additionally, superannuation funds – one of the largest domestic sources of long-term institutional investment – are already subject to considerable tax concessions.

Lowering the MIT withholding tax rate for BTR investments below 15 per cent was also not pursued as an option. The existing MIT withholding tax rate on foreign investment into affordable housing<sup>29</sup> is 15 per cent, which is the same as the BTR rate proposed by this policy. Aligning the BTR tax settings with those applying to affordable housing could incentivise foreign investors to refocus their investment from affordable housing to BTR.

Ensuring greater consistency of regulatory requirements between jurisdictions, by pursuing changes in State and Territory laws, has not been considered as an option. While it would reduce compliance and administration costs, in a federated system it is hard to achieve in a timely manner and there is no certainty it could be achieved.

## Option 1: Maintain the Status Quo

Under the current tax settings, MIT income attributable to residential properties used for BTR projects, is subject to the default withholding tax rate of 30 per cent – aligned with the top corporate tax rate.

Whilst BTR assets have developed recently and more are in planning stages, the sector remains a nascent industry in Australia and is not a well-established asset class. In April 2023, the Property Council of Australia (PCA) released a report prepared for it by Ernst and Young (EY), which estimated the current size of the BTR sector in Australia to be \$16.87 billion. That report also estimated the size of the BTR sector to be 72 projects, comprised of 11 constructed, 23 under construction, and 39 in planning, representing approximately 23,000 additional dwellings.<sup>30</sup>

However, this equates to only around 0.2 per cent of the total value of the residential housing sector. For comparison, the report noted that in the UK and USA this figure is 5.4 per cent and 12 per cent respectively.<sup>31</sup> This shows that BTR has struggled to establish itself in Australian in the same manner,


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<sup>29</sup> Affordable housing for tax purposes must satisfy the following conditions: the property must be fixed domestic residential premises; it must be rented or genuinely available for rent, at below-market rates to eligible tenants on low to moderate incomes; and rentals must be managed exclusively by a registered CHP.

<sup>30</sup> Ernst & Young, A new form of housing supply for Australia: build-to-rent housing report, p 18.

<sup>31</sup> Ernst & Young, A new form of housing supply for Australia: build-to-rent housing report, p 8.





despite significant demand for housing. If the industry is not supported, there is no reason to presume it will emerge from a state of nascency.

## Option 2: Reduce the MIT withholding tax rate in line with other comparable asset classes and require a portion of dwellings to be offered on a discounted basis.

This option involves reducing the MIT withholding tax rate for eligible BTR projects from 30 per cent to 15 per cent (as announced in the Government's 2023-24 Budget) for both rental income and capital gains (MIT fund payments, which are subject to withholding tax, are comprised of both income and capital gains). The reduction in the withholding tax rate will be for newly constructed projects only (where construction commences after 9 May 2023).

This option will reduce the withholding tax rate for BTR assets in line with other commercial real estate asset classes (such as offices, shopping centres and hotels), as well as investments in 'affordable housing' residential property, which are also subject to a 15 per cent withholding tax rate. Consistent with above asset classes, the reduced withholding tax rate will apply to both rental income and capital gains that are attributable to BTR developments.

This option will establish in federal legislation a common understanding of the BTR asset class that would receive comparable tax treatment. For example it will include the following elements:

- projects consisting of 50 or more apartments or dwellings to be made available to the general public;
- dwellings to be retained as BTR housing under single ownership for at least 15 years before being able to be sold;
- landlords must offer a genuine lease term option of at least 3 years for each dwelling.

Furthermore, the reduced MIT withholding tax rate will be subject to the condition that a minimum proportion of the dwellings are offered at a discounted rate. For example, a minimum 10 per cent of dwellings in the BTR development must be offered at a discount of at least 25 per cent relative to a comparable dwelling in the same development.

This option is silent on how the discounted units will be allocated to tenants. It is expected that BTR operators would allocate the discounted dwellings based on their own internal policies, or in line with any state and territory regulations where they apply.

This option leverages the expectation that states and territories include affordable housing thresholds as part of their planning and zoning rules to access their BTR land tax concessions. As a result, state and territory checks and balances are the key mechanism used to ensure discounted dwellings are rented out to appropriate households.

Currently only Queensland and the Australian Capital Territory (ACT) have affordability requirements attached to their BTR concessions. Queensland requires that tenants meet an income and an assets test to be eligible for affordable dwellings. In the ACT, CHPs must manage the affordable dwellings in BTR developments and offer them to eligible tenants as required by regulation. Furthermore, some state governments have introduced planning regulation incentives for affordable housing. For example, in New South Wales, the Government in some cases offers floor space ratio bonuses to encourage developers to deliver affordable housing.<sup>32</sup> In addition, from 1 June 2018, the *Planning and*

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<sup>32</sup> New South Wales Government, [Social and affordable housing](#), n.d., accessed 15 May 2024.



*Environment Act 1987* (Vic) included an objective to facilitate the provision of affordable housing in Victoria and as part of the Victorian Government’s housing strategy, planning system initiatives and reforms will be introduced to help address housing challenges, including for affordable housing.<sup>33</sup>

### Option 3: Reduce the MIT withholding tax rate in line with other comparable asset classes and require a portion of dwellings to be offered as affordable tenancies

This option involves reducing the MIT withholding tax rate for eligible BTR projects from 30 per cent to 15 per cent and requiring a portion of dwellings to be offered on a discounted basis (as offered in Option 2). Additionally, conditions are imposed on the allocation of the discounted dwellings. The conditions will ensure the discounted dwellings are offered as affordable dwellings for members of the community who may not otherwise be able to afford to rent a dwelling in a particular BTR development. The conditions could be based on criteria such as:

- Household income limits:
  - Some states and territories already require household income testing for their affordable housing policies, whether for BTR land tax concessions or planning purposes.
- Household asset limits;
- Tenants must be employed in particular ‘essential’ occupations
- Involvement of registered CHPs.<sup>34</sup>
  - CHPs have requirements both under the Australian Charities and Not-for-profits (ACNC) guidelines and at the state regulatory level regarding tenant eligibility and charging of rent. These go beyond a simple discount calculation to rent.

With respect to the setting of income limits, one option is as follows:

- Single adult: earning 120 per cent of annualised average weekly total earnings<sup>35</sup>.
- Couple, no dependents: earning 130 per cent off annualised average weekly total earnings.
- Family, one or more adults and one or more dependents: earning 140 per cent of annualised average weekly total earnings.

The above criteria are broadly similar to the approaches used to define affordable housing in Victoria, Queensland, and NSW for other housing regulations. Therefore, it is likely some industry participants would already be familiar with implementing these conditions.

Under this option, the additional conditions provide checks and balances at the federal level on the allocation of discounted dwellings. While not achieving a common definition of affordable dwellings to across jurisdictions and government programs for BTR developments, it will provide more certainty that housing will be made available to workers needing affordable rental properties closer to their jobs, transport and other necessary amenities.

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<sup>33</sup> Victoria Government, [Housing strategy](#), n.d., accessed 14 May 2024.

<sup>34</sup> Currently, MIT investments in ‘affordable housing’ must be managed by CHPs, refer to *Division 980—Affordable housing, Income Tax Assessment Act 1997*.

<sup>35</sup> Average earnings refer to ‘Full time adult average weekly earnings - original’ as reported by the ABS – not ‘seasonally adjusted’ and not ‘trend’. This is a gross (before tax) figure. This data point is typically released in May and November every year. As at November 2023, the figure is \$1,958.

## Cost benefit analysis of each option

Cost benefit analysis will be used to identify the option that provides the highest net benefit. The option providing the highest net benefit should be selected as the preferred method that most effectively address the Government's objective. As BTR is a nascent asset class, and some of the benefits from BTR and affordable housing are qualitative rather than quantitative, some costs and benefits could not be quantified.

### Option 1: Maintain the status quo

Maintaining the status quo means income from MIT investments in BTR developments will remain subject to the 30 per cent non-concessional withholding tax rate.

Under this scenario, Australia may still see some growth in BTR, especially as some state and territory governments have implemented their own concessions targeted at encouraging BTR investment. While state and territory land tax concessions target both domestic and foreign investors, concessions on foreign investor surcharges are targeted at foreign investors only. However, notwithstanding the 23 projects under construction and 39 projects in planning, a larger pipeline of suitable projects is needed.<sup>36</sup>

As noted above, the responsiveness of supply to demand is influenced by the broader economic environment, including the cash rate, mortgage rates, the cost of building materials and consumer inflation, and levels of disposable income. In addition, the ability of the market to respond to demand by providing additional housing stock is influenced by a number of factors including taxes, lending regulations, land prices, land availability, housing market regulations and grants.<sup>37</sup> As the NHSAC *report into barriers to institutional investment* notes, the rental market has been slow to respond to rising demand for rental housing which in part reflects these cyclical factors but also reflects deeper structural constraints on the capacity of the rental market to quickly and efficiently meet the housing needs of those who rely on rental accommodation.<sup>38</sup>

Given the impact of these factors it cannot be expected that in the absence of Government action the BTR industry will find ways to achieve target returns on investment and supply more housing. As such, Government action is necessary to support increased supply.

As noted above, notwithstanding the pipeline under construction or planning, the number of BTR dwellings in Australia is low in comparison to other countries.<sup>39</sup> NHSAC reports that institutional investment has sizeable allocations to Australian commercial, retail and industrial property<sup>40</sup>, all of which attract a 15 per cent withholding tax rate, half the rate that currently exists for BTR. Foreign institutions have funded most of Australia's existing BTR developments at around 80 per cent, or 3,909 dwellings.<sup>41</sup>

NHSAC also reported that office property accounts for 49 per cent of institutional investment in Australian property whilst retail is 35 per cent, industrial 11 per cent and residential (and accommodation) is only 1 per cent.<sup>42</sup> NHSAC also referred to data from JLL, indicating that whilst

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<sup>36</sup> NHSAC, *Barriers to institutional investment*, p 3

<sup>37</sup> NHSAC, *State of the Housing System 2024*, p 83

<sup>38</sup> NHSAC, *Barriers to institutional investment*, p 1

<sup>39</sup> Ernst & Young, *A new form of housing supply for Australia: build-to-rent housing report*, p 22.

<sup>40</sup> NHSAC, *Barriers to institutional investment*, p 2

<sup>41</sup> Ernst & Young, *A new form of housing supply for Australia: build-to-rent housing report*, p 18.

<sup>42</sup> NHSAC, *Barriers to institutional investment*, p 22

annual rental yield for the March quarter 2023 was 4.4 per cent, similar yields for logistics, student accommodation, retail, office and aged care were all higher, ranging from 4.8 to 6.5 per cent.<sup>43</sup>

The 30 per cent MIT withholding tax rate means other real estate investments (such as office, retail and commercial premises) will likely continue to attract more foreign investment due to lower yield provided by BTR assets.<sup>44</sup>

While domestic investors do not face higher taxation rates on BTR relative to other asset classes, they lack the experience in developing and managing BTR projects in Australia. Domestic institutional investment allocation data from ISPT, one of the largest fund managers of Australian unlisted property that invests on behalf of superannuation funds, shows most institutional capital is invested in: office (49 per cent), retail (35 per cent) and industrial (11 per cent) properties, while residential (including BTR) only represents 1 per cent of total property investment.<sup>45</sup> This is unlikely to substantially change until the BTR sector matures and the long-term returns have been proven.<sup>46</sup>

The status quo – including the 30 per cent MIT WHT rate – will continue to limit the attractiveness of the BTR asset class and the level of investment and growth. Without any government actions to attract foreign investors with experience in BTR, the BTR sector may not be able to achieve sufficient scale and momentum to attract follow-up investment by a broader range of investors. Costs to society from the lack of housing and affordable housing, and the other benefits provided by BTR housing relative to other forms of housing, will remain unchanged.

Additionally, the status quo will do little to increase the supply for affordable housings without any government actions. More than 80 per cent of the current BTR projects in planning stage are located in Victoria and New South Wales<sup>47</sup>, both of which do not have compulsory requirement for owners to include affordable tenancies to access their land tax concessions.

## Reducing the MIT withholding tax rate to be in line with other comparable asset classes

Overall, both Options 2 and 3 are expected to provide a net benefit over the status quo. The regulatory burden and government costs associated with providing the tax incentives are expected to be outweighed by the societal benefits that will accrue from increased rental supply and additional government receipts from increased investment.

### Impacts on the Government

Options 2 and 3 both provide a reduction in the MIT withholding tax rate from 30 per cent to 15 per cent. Treasury estimates that such treatment under both Options 2 and 3 would provide similar outcomes in terms of government revenue foregone. Government receipts are expected to decrease by \$30.0 million with an increase of government payments by \$4.3 million over the 5 years from 2022-23.

The decrease in receipts is based on the number of BTR properties in the current development pipeline and assumed growth in the apartment stock over the medium term. Treasury has assumed that due to the concessional rate, a significant portion of these properties will be operated by MITs

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43 NHSAC, Barriers to institutional investment, p 23

44 NHSAC, Barriers to Institutional Investment, Finance and Innovation in Housing, p 23.

45 NHSAC, Barriers to Institutional Investment, Finance and Innovation in Housing, p 22.

46 Ernst & Young, A new form of housing supply for Australia: build-to-rent housing report, p 38.

47 Ernst & Young, A new form of housing supply for Australia: build-to-rent housing report, p 18.



with significant foreign based equity. Income from rents is assumed to grow based on capital city apartment rent growth and this income will be remitted and withheld at the concessional rate.

While the ATO can leverage its existing infrastructure to administer a 15 per cent MIT withholding tax rate in the short term, additional infrastructure to allow it to effectively monitor the concessions on an ongoing basis and conduct compliance activities would be desirable.

The nascent BTR market is difficult to forecast at this time but any government revenue foregone as a result of these concessions could be partially offset by additional tax receipts generated by new BTR entrants, including by domestic investors encouraged by the successful expansion of the sector. The costing also excludes the revenue impact attributable to additional employment opportunities in the construction and property management industry.

Lastly, encouraging the private sector to increase housing supply and provide discounted housing to essential workers would, over time, reduce demand for direct government investment in housing construction through programs like the HAFF, which could result in overall financial savings for the Government. A tax concession will enable more projects to surpass minimum investment hurdles so they can proceed to development, bridging the funding or profitability gap that is currently a constraint on projects. This should support private capital to fund increased housing supply, absorbing some of the excess demand for housing (including from essential workers) and therefore reducing pressure on the Government to directly fund new dwellings.

## **Impacts on BTR investors**

The reduction in the MIT withholding tax rate will benefit foreign BTR investors by improving their after-tax returns. Improved returns means the sector is able to attract more investment, such that the number of new BTR projects funded by foreign investment is likely to increase, resulting in a boost in housing supply. The change in policy follows significant stakeholder feedback that the residential BTR sector is unable to attract investment under current tax settings for BTR, as they lead to lower returns than comparable assets, thereby directing foreign investment into these other assets. The reaction from the sector to the 2023-24 Budget announcement was positive.

Some new compliance costs will be imposed on developers and investors, who will need to ensure the eligibility requirements for the concessional withholding tax rate are met over the minimum holding period. This may include keeping records of income generated, floor space of BTR dwellings and the lease terms offered. Compliance costs for BTR developers are not expected to differ substantively from the status quo. Many BTR developers and owners already collect similar information as part of their general building operations, as well as to access any relevant state or territory BTR concessions.

Developers and investors may also incur initial transitional costs associated with seeking tax advice. That said, mechanisms exist to apply the existing 30 per cent withholding tax, so minimal adjustments to withhold the lower 15 per cent rate are expected.

While a positive increase in rental housing stock is expected in response to Options 2 and 3 as a result of the increased after-tax returns, it is difficult to provide a detailed estimation as the sector is nascent and market reaction. NHSAC reports that forecasting for housing markets is inherently uncertain<sup>48</sup>. Baseline projections for housing incorporate demand-side housing policy and migration policy measures enacted by the Government. They do not incorporate the effect of policy initiatives aimed at addressing supply constraints in the housing system that are expected to be implemented by different levels of Government. As such forecasts rely on the existence of past data to establish a trend and

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48 NHSAC, State of the Housing System 2024, p 81

project that trend into the future, this is particularly challenging for the BTR sector, which is not yet well established.

However, NHSAC also notes that it expects policy measures to likely result in a greater supply of housing than projected.<sup>49</sup> Predicting the increase in supply by any one measure is difficult but changes to BTR tax settings could increase supply significantly over the medium term. The level of response will likely differ according to the additional requirements on the allocation of the discounted dwellings. Requirements that impose a higher regulatory burden will limit investment returns and investment appetite for BTR. These impacts are explored further below.

In the medium to long-term the additional foreign investment into BTR is expected to create an expanded BTR market with sufficient depth and scale to attract new types of investors. As noted above, other countries with well-established markets have good quality data on revenues and costs associated with managing properties and have dedicated and transparent regulatory, legal and tax arrangements for the sector resulting from the development of case law and regulation over time. By deepening investment in the market through improved tax arrangements, these missing conditions for investment in the Australian market can be resolved, which will result in further investment as the sector emerges from its nascent stage<sup>50</sup>.

The NHSAC also states that risks are currently elevated due to the nascent state of the market and that the return-risk characteristics of a well-established and functioning market would be such that it is viable and self-sustaining.<sup>51</sup> Furthermore, a lack of consistent and sufficient number of large scale institutional housing assets, and a lack of a secondary market, creates investment risks for investors. Price discovery is limited, which adds to risk and complexity for trustees, it creates liquidity risk and reduces data available for investment and credit analysis, which also raises the cost of equity and debt. The lack of a market also raises uncertainty on about government policy.<sup>52</sup> Deepening the market by encouraging further investment will assist resolve these issues, encouraging further investment and increased supply. It may also address existing barriers for superannuation funds to invest in BTR and attract further investment including domestic institutions into this asset class.

## Impacts on society

The increased development of BTR assets will benefit renters and community members through increased supply, variety and choice of long-term rental options and the improved availability of housing in good locations.

Moreover, as noted above, the creation of new affordable dwellings in good locations will provide significant benefits for the wider society through enhanced productivity, such as lower costs of providing infrastructure, reduced commute times, better access to labour markets, and reduced housing stress.

It can also enable essential workers to live in the community in which they work and support, providing better access to essential services for the broader community, generating community benefits worth \$45,500 per tenant per annum according to Aware Super.<sup>53</sup> It is a common practice for essential services to arrange key workers on call for potential emergency situations. For example, having nurses and firemen living near the hospitals and fire stations they work in will increase essential service productivity and contribute to broader societal benefits.

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<sup>49</sup> NHSAC, State of the Housing System 2024, p 82

<sup>50</sup> NHSAC, Barriers to Institutional Investment, Finance and Innovation in Housing, p 27

<sup>51</sup> NHSAC, Barriers to Institutional Investment, Finance and Innovation in Housing, p 37

<sup>52</sup> NHSAC, Barriers to Institutional Investment, Finance and Innovation in Housing, p 42

<sup>53</sup> Aware Super, [Essential worker housing affordability crisis costing Australia \\$64 billion](#), 6 October 2023, accessed 14 May 2024.



Options that reduce the MIT withholding tax rate will operate in tandem with existing state and territory BTR incentives to increase BTR investment and maximise social benefit.

## Impacts to other property investments

The additional foreign investment in BTR stimulated by the tax concession is expected to comprise additional investment into Australia and some reallocation of existing investments in other Australian asset classes. The tax concession is expected to attract new investment given BTR is a nascent asset class that has not yet been fully explored by foreign and domestic institutional investors. Market activity has shown a growing interest from new-entrant institutional investors in the BTR sector.<sup>54</sup>

## Option 2: Reduce the MIT withholding tax rate in line with other comparable asset classes and require a portion of dwellings to be offered as affordable tenancies

This option requires that a portion of dwellings (for example 10 per cent) be made available at a discount (of at least 25 per cent) compared to an equivalent dwelling in the same BTR development.

An increase in the rental stock compared to the status quo is expected, benefiting the society. However, financial returns may be **impacted** where federal requirements are more onerous than those required by state or territory tax and planning rules.

The EY report indicated that the inclusion of a 10 per cent ‘affordable dwellings’ requirement could reduce an investor’s internal rate of return from 8.13 to 7.60 per cent (based on the 10-year BTR compliance period announced in the 2023-24 Budget). This reduced rate of return would have a consequential effect on the overall benefits of the reduced withholding tax rate on project profitability.

Queensland is currently the only state with a discounted rent requirement which is also set at a 25 per cent discount to comparable market rent dwellings in the same development.<sup>55</sup> These rules took effect from 1 July 2023, making it difficult to assess the overall impact of the discounted rent requirement on project numbers..


However, Option 2 does not prescribe conditions on accessing the discounted dwellings. Therefore, it is uncertain whether the discounted dwellings will be allocated to those on low to more moderate incomes who are genuinely in need of affordable housing. As a result, a risk of this approach is that tenants on higher incomes, who are able to afford market rents, may unintentionally be the beneficiaries of the affordable tenancies. Currently only Queensland and the Australian Capital Territory require a component of ‘affordable tenancies’ with flexibility in allocating the units as a condition to access their respective BTR concessions. Such flexibility permits owners to provide affordable dwellings that differ in relatively minor ways to other dwellings in the same development e.g. with regard to size, layout or the number of windows.

The compliance costs for Option 2 for BTR developers is expected to be low. The information collected is a subset of information that BTR developers and owners must already collect for either general building operations or to receive state and territory concessions or meet planning and zoning requirements. It does not add to these obligations. For example, records of rent charged (both at market rates and at a discount), income generated, floor space of the BTR dwellings and the lease terms offered are records that would need to be kept.

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<sup>54</sup> Colliers, [Residential Capital Markets Investment Review 2024](#), 8 February 2024.

<sup>55</sup> *Queensland Land Tax Act 2010* (Qld), s 58R.



It is likely that BTR development owners would have the necessary expertise and experience for dealing with various regulatory, financial and building (state and federal) requirements from their experience in constructing and operating exiting BTR projects overseas.

Another vital factor is the importance of environmental social and governance (ESG) considerations for both investors and developers. Institutional investors may be inclined to make broader contributions to society through their involvement in providing affordable housing and can be an important auxiliary benefit for investors in supplying BTR.

While Option 2 is expected to provide a net benefit compared to the status quo, it is uncertain whether this option would benefit people who genuinely need the affordable housing, and hence whether it would deliver the productivity benefits that come from providing essential workers with well-located and affordable housing.

### **Option 3: Reduce the MIT withholding tax rate in line with other comparable asset classes and require a portion of dwellings to be offered as affordable tenancies and restrict eligibility for affordable tenancies**

In addition to Option 2, this option includes additional federal requirements to ensure that these dwellings are made available to households on low to more moderate incomes, rather than those on higher incomes who are able to afford BTR dwellings at market rent (since BTR is currently considered as a premium product, a discounted BTR offering will be priced at a level where those on more moderate incomes will be able to afford it, rather than those on very low incomes).

Implementing eligibility criteria to limit who can inhabit affordable BTR dwellings could be achieved through either requiring CHPs to manage the properties or by introducing income limits on the tenants of the affordable BTR dwellings. The approaches will have different costs and benefits for investors, developers and tenants.

If income limits are used, as proposed, the burden of determining eligibility will fall on BTR managers who will collect information from tenants on their income when commencing and renewing leases. Stakeholders expressed during consultation that this is consistent with existing wide-spread practices of collecting information on prospective tenants' income, and likely to be only a small additional regulatory burden. Thus the costs are likely to be similar or slightly higher than Option 2, given there are significant overlaps with existing record-keeping requirements.<sup>56</sup>

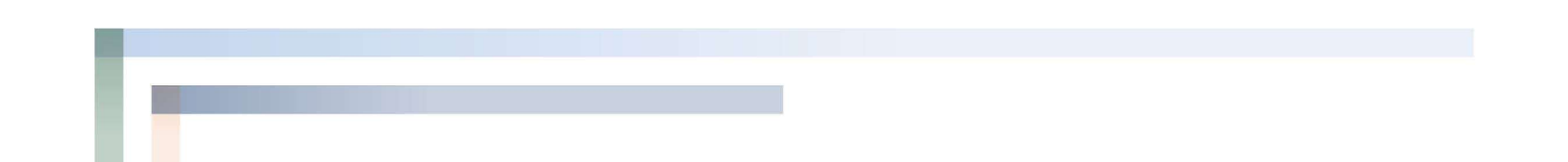
For BTR managers and tenants, the benefit of the income limit approach compared with a CHP requirement is that the single management benefit of BTR is maintained. This potentially allows for a more seamless administration of the BTR property for both the owner and the tenants.

On the other hand, if 'affordable tenancies' are required to be managed by a registered CHP (as is the case to access the current 15 per cent final withholding rate for investments in affordable housing), this could add significant cost and complexity to some BTR projects. Rent charged by CHPs may be at a steeper discount as their target clients are those on very low or low incomes rather than more moderate incomes. Internal communication and management costs may be higher, offsetting some of the efficiencies of a single ownership control structure. These costs would negatively impact on the return on investment for BTR owners, potentially resulting in less investment and less housing supply.

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<sup>56</sup> Note different requirements apply in different states and territories concerning collection of information from rental tenants.





However, some stakeholders indicated the specialist skills provided by CHPs can be beneficial in certain circumstances, and even without any explicit requirement for CHP involvement, some BTR owners may still choose to use them. CHPs are experienced tenant managers and are best placed to manage vulnerable tenants and provide specific support services for low income earners. However, this is less relevant for BTR affordable housing where the below market rent housing is more likely to be provided to less vulnerable clients such as key workers<sup>57</sup>.

CHPs are required to adhere to regulations and ensure, under law, that they offer housing that provides 'relief from poverty' and not unjustified private benefit.<sup>58</sup> This implies the discount to market rent on affordable dwellings managed by a CHP may need to be lower than 74.9 per cent, causing a further reduction in profitability and feasibility of BTR projects. As a consequence, the decrease in returns from this requirement may outweigh the increase resulting from the concession.

As the BTR sector matures, and a broader range of properties are brought to market, including those that have a market rent targeted more towards middle income earners, CHPs managing affordable tenancies suitable for lower-income tenants may achieve better housing outcomes. It may be that a flexible approach is preferable to minimise regulatory burden.

Like Option 2, developers and investors may also incur initial transitional costs associated with seeking tax advice. There may be changes in the relative merits of different types of real estate investments because of the change in the withholding tax rate. As acknowledged for Option 2, mechanisms exist to apply the existing 30 per cent withholding tax, so minimal adjustments to withhold at 15 per cent are expected. Fund managers for MITs generally would have the necessary expertise and experience for dealing with various regulatory, financial and building (state and federal) requirements.

The ATO could be expected to incur some additional costs to regulate this option. Costs will differ depending on range of checks and balances applied to the BTR MIT withholding tax rate concession. The involvement of CHPs in relation to affordable housing would provide the ATO with an objective test when undertaking client engagement activity. If CHPs are not involved in managing affordable tenancies, then the ATO would need to check taxpayers' compliance with the income limits for affordable tenancies, such as by examining property managers' policy documents and records of assessing tenant eligibility.

This option is expected to generate an increase in rental stock compared to the status quo, benefiting the community, although the additional supply may not be as great as under Options 2 (noting that the supply response is hard to estimate). However, Option 3 is expected to provide the greatest net benefit as it ensures both an increase in affordable rental dwellings and that households genuinely in need of affordable housing most likely benefit from it. This is particularly important as lower-income households continue to face poor housing affordability.<sup>59</sup>

The requirement to apply income limits in assessing the eligibility of tenants for affordable housing is a necessary integrity measure that ensures those in most need of affordable housing are the beneficiaries. The limits have been set such that those households on around average or lower incomes are eligible. This includes key workers such as police officers, nurses, emergency workers and teachers. Individuals in these professions particularly benefit from residing close to employment. Furthermore, the income eligibility criteria are designed to be a simple test that is easily conducted, regardless of if a developer or CHP is managing affordable dwellings.

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<sup>57</sup> NHSAC, Barriers to institutional investment report, p 49

<sup>58</sup> Australian Charities and Not-for-profits Commission, [Commissioner's Interpretation Statement: Provision of housing by charities](#), ACNC website, 5 November 2021.

<sup>59</sup> NHSAC, State of the Housing System 2024, p 95



# Consultation plan

## 2023-24 Budget announcement

The 2023-24 Budget measure *‘Housing (Build-To-Rent Developments) – accelerating tax deductions and reducing managed investment trust withholding tax rate’* outlined the eligibility criteria for the measure, including that it would apply to BTR projects consisting of 50 or more apartments or dwellings made available for rent to the general public. The dwellings must also be retained under single ownership for at least 10 years before being able to be sold and landlords must offer a lease term of at least 3 years for each dwelling. Further, the measure noted that *“consultation will be undertaken on implementation details, including any minimum proportion of dwellings being offered as affordable tenancies and the length of time dwellings must be retained under single ownership”*.

## Targeted consultations

Treasury undertook targeted consultations in the second half of 2023 to explore alternative policy options and inform the development of the exposure draft legislation. This included participants from industry associations, developers, investors (both domestic and international) and community housing organisations. It also involved discussions with state and territory officials regarding existing support that state and territory governments provide to BTR developments. The input received from stakeholders during targeted consultation informed the development of the exposure draft legislation.

## Public consultation on Exposure Draft

Exposure draft legislation was made available for public consultation from 9 April 2024 to 22 April 2024. Treasury received 37 submissions (including 5 confidential submissions) from interested stakeholders. Stakeholders were broadly supportive of the Government’s policy objective.

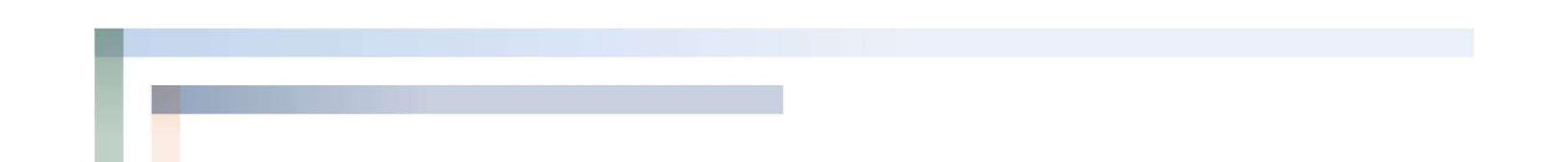
The draft legislation reflected Option 3 which required a minimum 10 per cent of dwellings to be made available as affordable dwellings with at least 25 per cent discount to market rent. Household income will be used to determine if tenants are eligible for occupying the affordable BTR dwellings. Furthermore, the draft legislation included a minimum period of 15 years during which dwellings must be retained under single ownership and comply with the affordable tenancy requirement.

## Stakeholder views

The most common, and strongest, concern raised by stakeholders was that the concession applied in the legislation was not sufficient. Most stakeholders argued that it would not make BTR an attractive investment, relative to other property asset classes in Australia. Further, stakeholders were concerned that the benefits of the concession would be offset by the requirements to have 10 per cent of dwellings made available at an affordable rate.

Stakeholders suggested the following changes, to align the application of the MIT withholding concession with the treatment of other property asset classes.

- the concessional 15% MIT withholding tax rate should extend to fund payments that include capital gains attributable to a BTR development (and not be limited to rental income);
- the concessional 15% MIT withholding tax rate should apply beyond the first 15 years of a BTR development if the development remains compliant.



The Government agreed to adjust the draft legislation in line with these suggestions to ensure the final legislation achieved the policy objective of incentivising foreign investment in BTR, including through the supply of affordable housing.

A capital gains tax event can happen when investors sell their investment in a BTR projects when they exit the market, and the net capital gain is treated as a part of income in the tax laws. The adjustment to include capital gains in this concession is consistent with other MIT withholding tax rate concessions, including those applying to commercial buildings and affordable housing.

Stakeholders indicated they would be unable to make initial investment decisions without the clarity of the tax treatment to their 'exit strategy'. The Treasury's costing indicates the change will have negligible impact over the forward estimates. As a result, legislative changes were made to include capital gains in the withholding tax concessions.

Although this policy requires investors to operate the BTR projects for 15 years, stakeholders have indicated that a BTR project could continue operating for longer. To end the withholding tax concessions at the end of 15-year compliance period would force investors to exit the market, and potentially not invest in the first place. Extending the concession for as long as a BTR project complies with the eligibility criteria will help preserve the benefits of BTR over a longer period, without requiring investors to consider costly and complex decisions on managing or replacing their investments.

Treasury also carefully considered stakeholder comments on the following topics.

## **Affordable dwellings**

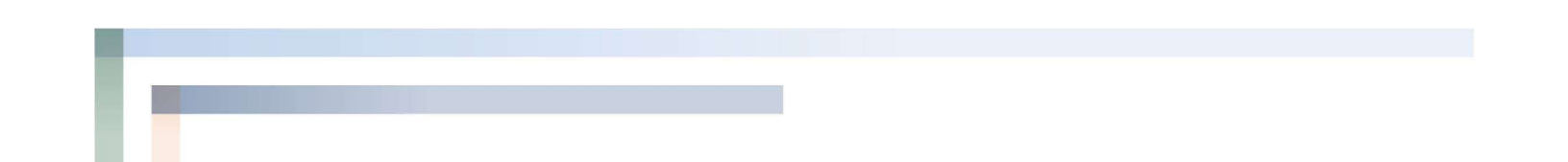
Stakeholders noted throughout the targeted consultation and consultation on draft legislation that the commercial viability of BTR developments would be sensitive to the size and nature of the 'affordable housing' requirement.

Current MIT investments in assets used to 'provide affordable housing' require the affordable dwellings to be managed by a registered CHP with specialised expertise in helping low and very low-income households find tenancies. If applied to the BTR context, stakeholders were concerned this could negate the benefits of a single ownership control structure and add complexity and cost to BTR projects, which may be passed onto tenants.

Further, BTR developments are typically targeted at the premium segment of the market, so targeting rents toward people on around average or lower incomes would have a significant impact on project revenues that could outweigh benefits of the MWH concession. A discount to market rent in a premium market will more likely cater to those on more moderate incomes, such as key workers, rather than those on very low or low incomes, and have a smaller impact on project revenues.

BTR developers broadly advocated for additional incentives to provide affordable dwellings, such as a further reduction in the MIT WHT rate. Some stakeholders suggested that an affordability component should be excluded from the eligibility criteria and addressed by a separate measure.

Stakeholders noted that some state and territory governments already require an 'affordable' tenancy element either as part of eligibility for their BTR concessions or for planning and zoning purposes. Some parties were of the view that the presence of state and territory requirements in this space was a compelling reason to exclude affordability elements from this BTR incentive. However, BTR concessions differ across states and do not exist in all states. Others considered this measure as an opportunity to set a national standard. In this regard, Treasury notes that the Housing and



Homelessness Ministerial Council agreed on 20 November 2023 to develop an options paper for a nationally consistent approach to affordable housing.<sup>60</sup>

Other groups in particular community housing associations considered that a specific affordable tenancy requirement will assist the Government in delivering more long-term supply of affordable rental dwellings and support its goals of increasing the supply of safe, stable and affordable rental dwellings.

Acknowledging these concerns raised by stakeholders and the Government's housing policy objectives, the final legislation will retain an affordable housing requirement that will not require the use of CHPs to manage the affordable dwellings and will express the 'affordability' criteria as a discount to market rent, targeted at tenants on more moderate incomes. The dwellings must be offered to the general public, so they can't be operated as, for example, student or own-employee housing. The income limits have been designed to ensure key workers such as emergency workers, police officers and teachers are eligible. The affordability requirement has been expressed to be compatible with existing state and territory legislation on BTR, and further clarification is being provided in the Explanatory Memorandum.

Treasury has also made minor adjustments to how the affordable dwelling requirement is expressed to address industry concerns that the requirement that it be comparable with the non-affordable housing was too rigid, for example, because of variations between units in the same dwelling or the difficulties applying it to every type of dwelling e.g. where there may be a small number of penthouse apartments.

## Existing BTR developments

Some stakeholders pressed for existing BTR projects and BTR projects that were in development prior to 9 May 2023 to be eligible for the concessions. They argued that excluding such projects unfairly penalises the operators, who have been at the forefront of BTR in Australia.

Extending the measure to include pre-existing BTR projects will provide a gain to projects that have already been considered commercially viable and are already operating or under development, and therefore would not increase the supply of housing or affordable housing relative to the status quo. It would also impose an additional cost to the Government budget in the form of forgone tax revenue, over the life of the BTR projects – potentially decades.

## Single ownership retention period

The exposure draft legislation included a minimum period of 15 years during which dwellings must be retained under single ownership. This contrasts with the 2023-24 Budget which indicated a minimum period of 10 years, and that Treasury would consult on it being a longer duration. 15 years was chosen to balance the need for institutional investors to maintain some liquidity in their capital investment and ensuring that in the BTR developments achieve the objective of providing additional rental housing over the medium-term.

Stakeholders generally agreed that the BTR asset class is a long-term passive investment- and were broadly comfortable with a 15-year period retention period. This period is also consistent with some state and territory concessions.

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<sup>60</sup> The Hon Julie Collins MP, [Housing and Homelessness Ministerial Council meeting](#) [media release], Australian Government, 23 November 2023, accessed 13 May 2024.

## Misuse tax

The exposure draft legislation contained a BTR misuse tax to neutralise tax concessions provided to a BTR development that became non-compliant during the 15-year BTR compliance period. Stakeholders were concerned the application of the misuse tax can be triggered by any form of non-compliance with the affordability requirements. This means a BTR developer will be liable for the misuse tax upon an inadvertent small or minor breach. The draft legislation did not provide any flexibility or opportunities for the BTR developer to address non-compliance.

In response to stakeholder concerns, the proposed legislation will provide the Commissioner of Taxation with the discretion to treat the BTR development as compliant upon certain conditions.

## Option selection and implementation

The table below provides a summary of the cost and benefits of each option.

Impacts	Option 1 – Status quo	Option 2	Option 3
Society	<p>Lack of housing and affordable housing supply.</p> <p>Limited access to benefits of BTR such as longer tenancies, efficient maintenance, ancillary services, etc</p>	<p>Benefit from increased housing and affordable housing supply in good locations, and services such as longer tenancies, efficient maintenance and ancillary services.</p> <p>Increase in affordable housing which is essential infrastructure that reduces homelessness, poverty, supports economic productivity and labour market participation. It also fosters more cohesive, diverse and sustainable communities.</p> <p>However, full benefit may not be realised with tenants on more moderate incomes (such as key workers) potentially missing out on opportunities to rent in BTR developments due to poor administration of criteria.</p>	<p>Benefit from increased housing and affordable housing supply, and additional services associated with BTR.</p> <p>More certainty on the benefits arising from tenants on more moderate incomes having access to affordable housing in good locations.</p> <p>Increase in affordable housing which is essential infrastructure that reduces homelessness, poverty, supports economic productivity and labour market participation. It also fosters more cohesive, diverse and sustainable communities.</p> <p>Increased availability of affordable accommodation that is well-located, improving access for those on moderate incomes to the labour market and increasing productivity.</p>
Government	<p>No change in costing with respect to the policy change.</p> <p>However, without private housing built by institutional investors, the Government may be required to make more direct investment in public housing through programs like the HAFF.</p>	<p>Cost from reduced receipts and increased payments.</p> <p>Cost from implementation and enforcement of tax incentive.</p> <p>The demand and cost for further government direct investment in housing through programs like the HAFF will be reduced.</p>	

BTR development owners	No change	Benefit from higher returns.	Benefit from higher returns but less than under Option 2.  Benefit from lower levels of tenant vacancy and turnover in affordable housing.
Net benefit compared to Option 1		Net benefit over Option 1	Greatest net benefit

The recommended option is Option 3 – reduce the MIT withholding tax rate to 15 per cent and require a portion of dwellings to be offered at a discounted rate as affordable tenancies. This option provides the greatest net benefit as it most effectively addresses the objective to increase the supply of rental housing, including affordable housing.

Treasury analysis indicates the impact on an average BTR project’s investment returns under the various options. The Internal Rate of Return (IRR) is used to judge the profitability and feasibility of projects. Under the status quo, the IRR remains at 5.1 per cent. Applying the concession without requiring any affordable housing increases this average IRR to 7 per cent. Under options 2 and 3, including affordable housing, the average IRR is 6.3 per cent. This improvement in IRR from the status quo represents a significant net benefit from the measure.

Options 2 and 3 are expected to deliver an increase in BTR housing supply compared to the status quo. Incentivising foreign investment would bring foreign BTR expertise and scaling onshore and attract a broader range of investors, including domestic institutions, to the BTR sector in the long term. This would further increase the housing supply and create jobs for construction and property management industry in Australia. However, the supply response will vary relative to the impact on rates of return and compliance costs imposed by each option. Government receipts are expected to decrease similarly for all options when compared to the status quo. The benefits provided from increases in housing supply to Australian households is expected to outweigh the decreases in government receipts.

Options 2 and 3 improve tenant outcomes by ensuring a portion of the BTR development is provided at more affordable rents. But only option 3 ensures that affordable housing benefits the target cohort. While the IRR is lower for these options, they deliver important societal benefits. Affordable housing is essential infrastructure that has been found to reduce homelessness, poverty, supports economic productivity and labour market participation. It also fosters more cohesive, diverse and sustainable communities.<sup>61</sup> In addition, despite a lower IRR, requiring affordable housing also complements ESG goals of investors and developers and brings benefits from lower levels of tenant vacancy and turnover in affordable housing.<sup>62</sup> Option 2 does not require the discounted dwellings be offered to households genuinely in need of affordable housing. Instead, the BTR operator has discretion to offer affordable tenancies to anyone, including those capable of affording dwellings at market rent. Or they could design their own eligibility criteria – however there is no requirement to do so. State and territory regulations on affordable housing will still apply if the BTR operator chooses to apply any land tax or other concession.

Option 3 maximises society benefits by ensuring the discounted dwellings are only offered to households that may otherwise face challenges in obtaining a suitable rental property. This is expected to increase the supply of affordable housing and at market housing. The impact on after-tax return, including both reductions in rent and compliance costs, will vary depending on the conditions imposed on the allocation of the discounted dwellings.

<sup>61</sup> NHSAC State of Housing system report p 151

<sup>62</sup> NHSAC, Barriers to Institutional Investment Report, p 24

Overall, Option 3 provides the greatest net benefit as it is most appropriate at addressing Australia’s housing supply issue for both rental houses and affordable housing. Option 3 strikes the right balance between providing incentives for rental housing supply, increasing the supply of affordable dwellings and appropriate requirements for the eligibility of the affordable dwellings. The application of income limits will ensure households truly in need of affordable housing will benefit from these dwellings. Eligible tenants could include key workers such as emergency workers, police officers and teachers who particularly benefit from proximity to employment. Income limits have been determined with consideration of the earnings of key workers such as emergency workers, police officers and teachers. Such tenants on more moderate incomes and in need of affordable housing may also reduce turnover for developers. In addition, affordable accommodation promotes workers and employers’ access to the labour market, increasing productivity.<sup>63</sup> It is expected that the majority of BTR developments eligible for the federal concessions will likely also benefit from state and territory incentives, increasing the overall financial return on their projects. Therefore, housing supply including affordable housing is expected to increase.

The measure will be implemented by legislation with the ATO responsible for administration. The implementation plan is as below.

Action	Timeframe
Government announcement	9 May 2023 (Budget)
Development of exposure draft legislation, including initial outreach consultation	June 2023 – April 2024
Public consultation on exposure draft legislation	April 2024
Treasury consideration of consultation feedback	April – May 2024
Introduction into Parliament	May 2024 (Winter sitting)
MIT withholding tax concession start date	1 July 2024

Timing of the passage of legislation can be affected by a range of factors, including parliamentary priorities. Unlike income taxation measures which could possibly be implemented prior to the end of the relevant income year, withholding taxes are withheld from payments of income as it is earned, meaning this measure should be in place before BTR owners commence earning revenue (the commencement date specified in the 2023-24 Budget is 1 July 2024).

Should the risk of delays beyond 1 July 2024 not be able to be mitigated, the Government may need to delay the start date of the legislation.

## Evaluation and review

The effectiveness of the preferred option can be monitored and evaluated against the Government’s objective as outlined in the table below.

Objectives	Success metrics
<ul style="list-style-type: none"> <li>Housing and affordable housing supply</li> <li>Investment into BTR</li> </ul>	<ul style="list-style-type: none"> <li>The proportion of BTR in Australia’s residential market</li> <li>BTR market volume</li> <li>Foreign investment proposals on BTR developments</li> </ul>

<sup>63</sup> 2021, AHURI, Urban productivity and affordable rental housing supply in Australian cities and regions, p 28

- MIT withholding tax incentive uptake

As a general indication, the BTR market in Australia has the potential to grow over the long-term from its current size of less than 0.2 per cent of the residential housing sector (or \$16.87 billion) to 3 per cent (\$290 billion).<sup>64</sup>

Treasury and the ATO will monitor the operation and uptake of BTR developments after implementation to consider whether the policy has been effective in achieving its intended outcome and the cost of achieving such outcomes. This would include monitoring the growth of the BTR market compared to the whole residential sector, together with foreign investment proposals that involve BTR developments. Treasury will also work with the ATO to identify any behavioural responses from BTR owners which may require additional integrity measures.

Treasury will also consider the State of the Housing System report published each year by the NHSAC. It reports on conditions in the housing market, including housing supply and housing affordability and can be expected to report on any trends in BTR market.

Consistent with standard practice, after implementation Treasury and the ATO will continue to review the operation of the law. Treasury does not consider the inclusion of a sunset provision to be necessary for this proposal. BTR projects are long-term investments. A sunset provision may introduce regulatory uncertainty and deter potential investors.

Further, the success of this proposal will be monitored through ongoing consultations, in particular with property industry representatives and community housing groups. This will include continued engagement with stakeholders to better understand whether practical application of the affordable tenancy requirements gave rise to any unintended consequences and/or unnecessary compliance costs. Subject to these considerations, Treasury will assess whether a subsequent technical amendment process and/or review is required.

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<sup>64</sup> Ernst & Young, A new form of housing supply for Australia: build-to-rent housing report, p 22.

## Appendix 1: Status of the IA at each major decision point

Decision point	Timeframe	Status of the IA
Minister made announcement to increase the supply of rental housing by offering incentives on BTR developments	April 2023	Discussed with OIA the need for an IA. OIA indicated an IA is required as this policy is more than likely to have a minor impact. Prepared and provided draft IA to OIA for feedback.
Identification of viable policy options and preferred option	June 2023 – May 2024	Consulted with stakeholders to develop policy options and collected information for cost-benefit analysis in the IA. Revised draft IA provided to OIA for feedback. First Pass Final Assessment completed. Second Pass Final Assessment completed.
Final decision on policy and introduction of legislation into parliament	May 2024	Assessed IA provided to decision maker.