Exposure Draft – Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2017: additional CGT discount & providing affordable housing through MITs – **UDIA RESPONSE September 2017**

INTRODUCTION

The Urban Development Institute of Australia (UDIA) is the peak industry body representing the property development industry throughout Australia, acting on behalf of over 2,100 member companies across the country from a variety of fields and professions in the development industry. Established at a state level in 1963, the Institute evolved to become a national body with a number of State-based divisions in 1970.

UDIA aims to secure the economic success and future of the development industry in Australia, recognising that national prosperity is dependent on our success in housing our communities and building/rebuilding cities for future generations.

UDIA welcomes the opportunity to provide this submission to the Commonwealth Treasury on the Exposure Draft: Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measure No. 2) Bill 2017 - additional CGT discount & providing affordable housing through MITs (September 2017).

We support the proposed incentives to provide additional Affordable Housing by providing an additional Capital Gains Tax discount; however we are concerned in its current form the Bill would prevent the development of the 'Build-to-Rent' sector in Australia, which currently has a large amount of institutional investment interest.

This year UDIA has focussed its advocacy on addressing housing affordability through new and innovative solutions. In June UDIA NSW launched its' – Making Housing more affordable paper (copy attached) which brought together a Taskforce of 20 senior industry executives from diverse ends of the development sector, including Community Housing Providers (CHPs), banks, developers and planners to provide a comprehensive action plan. This Taskforce endorsed the development of a new asset class in Build-to-Rent products with the potential to attract billions of dollars of investment and to increase the supply of affordable market rental housing and to support government outcomes for Affordable Housing.

Build-to-Rent is a well established market product in many other countries with development in the United States of in excess of $150b which involves private companies and institutions building residential accommodation (usually medium & higher density typologies) and leasing this stock out to the market. For various reasons, this sector has not developed in Australia and UDIA believes enabling the development of the Build-to-Rent sector to emerge can significantly assist in tackling the Australian housing affordability crisis.

We consider the following benefits can arise from a Build-to-Rent housing sector in Australia:

- Development of large quantities of well-located market rental stock in areas of strong demand using new sources capital helping plug a large market gap.

- Large institutions investing in rental accommodation can offer greater security of tenure to longer term renters with multi-year leases and more efficient management and maintenance.

- The ability to integrate market and affordable housing products within single complexes, providing more places for Affordable Housing and in more diverse locations (e.g. Transit Orientated Development is an efficient smart city opportunity for our major cities).

In September 2017, the Council on Federal Financial Relations Affordable Housing Working Group identified that 'Build-to-Rent' models deserve further exploration in Australia. We consider it would be premature to disallow the market to investigate and invest in this innovative product that can provide relatively more affordable housing for people with more secure tenure.

We support encouraging institutional investors investing in housing and growing the stock of Affordable Housing within Australia. Additional Capital Gains Tax discounts will provide an incentive to invest in Affordable Housing, supported by a bond aggregator, however the investment returns are unlikely to meet the hurdles required for most institutional investment, unless it is part of a blended product including Build-to-Rent market housing.

We make the following recommendations:

1. **The Bill is amended to allow Managed Investment Trusts to invest in residential properties, to allow the establishment of a 'Build-to-Rent' market in Australia, where there is a minimum of say 20% Affordable Housing product to be managed by CHPs.**

2. **Further research is required as to the viability of the 'Build-to-Rent' sector and how it can work to support the development of Affordable Housing in addition to adding significant supply levels of affordable rental stock into areas of high demand.**

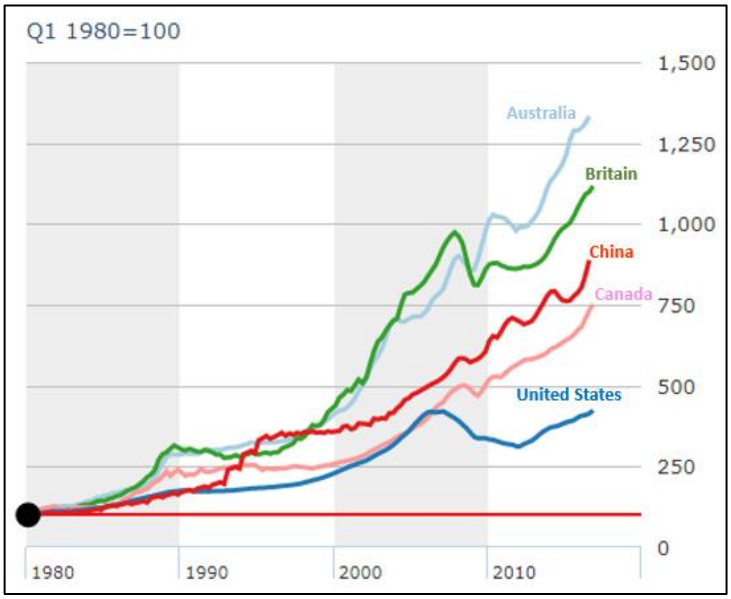
1. Housing Affordability: A Global Challenge

Housing affordability is a key challenge faced by many governments across the globe. Ensuring that a sufficient supply of housing is available to citizens to buy or rent at various price points is an enduring policy issue which almost always requires a multi-pronged policy approach to deliver sustainable economic outcomes.

Housing Affordability refers to the relationship between expenditure on housing and household incomes, this is different to the concept of Affordable Housing, which refers to housing for very low, low or moderate-income households.

A comparison of Australia's indexed house prices over the 1980 to 2016 period to those in Britain, China, Canada and the United States (as displayed in Figure 1) reveals that relative house prices are currently much higher in Australia than these other markets – despite strong growth across all these countries housing markets in recent years.

Figure 1: Indexed House Prices, 1980 – 2016



Source: Economist.com

Figure 2: International Housing Affordability Survey (2017)

International Least Affordable Rank	Market Name	Median Multiple
1	Hong Kong (China)	18.1
2	Sydney, NSW (Australia)	12.1
3	Vancouver, BC (Canada)	11.8
4	Auckland (New Zealand)	10
5	San Jose, CA (USA)	9.6
6	Melbourne, VIC (Australia)	9.5
7	Honolulu, HI (USA)	9.4
8	Los Angeles, CA (USA)	9.3
9	San Francisco, CA (USA)	9.2
10	Bournemouth & Dorset (UK)	8.9
11	San Diego, CA (USA)	8.6
12	London (Greater London Authority) UK	8.5
13	Toronto, ON (Canada)	7.7
14	Plymouth & Devon (UK)	7.1
15	London Exurbs (UK)	7.1
16	Adelaide, SA (Australia)	6.6
17	Bristol-Bath (UK)	6.2
18	Brisbane, QLD (Australia)	6.2
19	Perth, WA (Australia)	6.1
20	Miami, FL (USA)	6.1

Source: Demographia (2017)

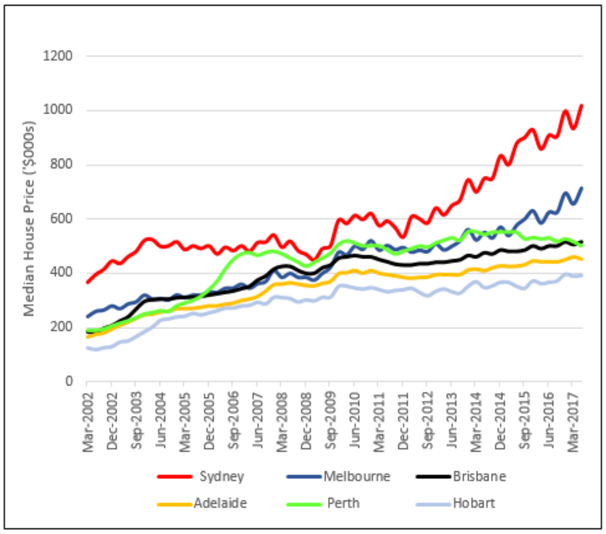
The Demographia International Housing Affordability Survey (which benchmarks Australian cities against cities from across the US, Canada, UK, China, Ireland, New Zealand and Singapore) considers any housing market with a median multiple of 5.1 or higher as 'severely unaffordable'. On this basis all of Australia's capital cities have been ranked as severely unaffordable over the last 7 years.

In 2017 the Demographia survey ranked Sydney as the second least affordable housing market in the world (trailing only Hong Kong) and the remainder of Australia's capital cities were also ranked in the top 20 least affordable markets.

2. Overview of Australia's Housing Affordability Challenge

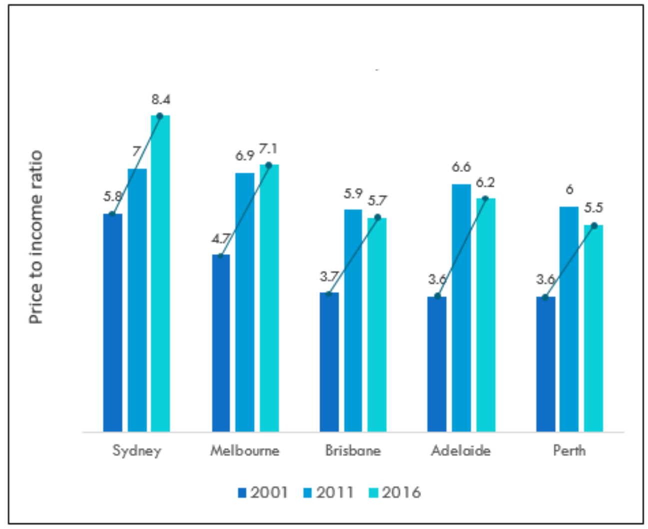
House prices have grown dramatically in Sydney (circa +70%) and Melbourne (circa +47%) over the 2012-2017 period. While growth has been relatively more benign in other capitals (and indeed prices have been retracting in Perth) housing affordability is considerably worse now than it was in 2001 across all Australian capital cities.

Figure 3: Australian Capital City House Prices, 2002-2017



Source: ABS

Figure 4: Ratio of Median Dwelling Price to Median Gross Household Income 2001, 2011 & 2016



Source: CoreLogic

The affordability 'crunch' is particularly acute in Sydney – and getting worse. According to CoreLogic it currently requires x8.4 the median household income to afford (i.e. pay no more than 30% of gross income) the median house price in Sydney ($1,020,000) which is up from x5.8 in 2001.

In Melbourne it currently requires x7.1 the median household income to afford the median home (up from x4.7 in 2001), x5.7 in Brisbane, x6.2 in Adelaide and x5.5 in Perth. This reflects the lack of housing affordability in the market.

(Please note – CoreLogic's benchmark medians are slightly different than that used by Demographia hence the divergent median multiples reported. The key point however is the order of magnitude of the median multiples and relativities between markets and changes over time).

3. Deteriorating housing affordability is a supply issue

There is a serious level of unmet demand for social and affordable housing across Australia with over 152,000 households currently on waiting lists. In June 2011 the National Housing Supply Council estimated that there was a deficit of 539,000 affordable rental properties for lower income renters. Assuming this quantum is roughly equivalent in 2017 (indeed it is more than likely to be a significantly elevated number given the price inflection over recent years) a circa $180b investment would be required to meet this demand.

While the Affordable Housing sector undoubtedly needs significant investment there also needs to be significant release and development of new supply in the broader market to close the residential dwelling gap.

Recent ANZ Research (published in 2016) estimated that despite the recent residential building boom, there remains a shortage of circa 250,000 dwellings across Australia based on Australia's underlying housing market balance. This translates into a required investment of circa $170b to catch-up.

The largest dwelling supply gap has centred on Sydney with a current deficit of circa 100,000 dwellings – with the backlog having built steadily from 2002. UDIA is of the view that the chronic undersupply of dwellings in Sydney has had a demonstrable impact on price growth pressure.

Harnessing a circa 100,000 dwelling backlog it is forecast that Sydney requires 41,250 new dwellings each year between now and 2036 in order to meet the current population growth demand profile and close the supply gap. This level of housing completions has never been achieved before in Sydney. Accordingly, it is contended that new mechanisms are required to 'turbo charge' supply – over and above the various measures which the NSW government are currently pursuing. Therefore significant institutional funds are required to bridge the gap between market and non-market housing. Build-to-Rent can help bridge the funding gap.

Australia's housing market is changing with increasing demand for rental accommodation and increasingly also for small apartments. The Millennial cohort are preferring flexible rental apartments located close to CBDs and public transport. Rental vacancies remain low across the country (as shown in Figure 6 below) and demand for rental apartments is expected to continue to grow – particularly in Central, Inner and Middle ring suburbs of our capital cities.

Figure 5: National Residential Vacancy Rates

City	August 2016	July 2017	August 2017
Adelaide	1.9%	1.8%	1.6%
Perth	5.0%	4.9%	4.6%
Melbourne	1.9%	1.7%	1.7%
Brisbane	2.7%	3.3%	3.1%
Canberra	1.1%	1.2%	1.0%
Sydney	1.7%	2.0%	2.0%
Darwin	3%	2.9%	2.5%
Hobart	0.5%	0.5%	0.4%
National	**2.3%**	**2.3%**	**2.2%**

Source: SQM

4. Build-to-Rent Can Help Bridge the Gap

The Build-to-Rent sector is a cornerstone of housing markets in various countries including North America, Japan and mainland Europe. Known as 'multifamily residential' in the USA, the sector delivered 380,000 new apartments starts across the US in 2016 - in buildings with more than five units. The number is higher than anything achieved in the pre-GFC boom, and the multifamily development market now dominates the supply of new housing in the USA.

These products tend to provide greater security and tenure for residents, with greater opportunities for tenants to personalise their homes while providing an option that is relatively more affordable than outright home ownership.

The US National Multifamily Council estimates that as of 2016 there more than 38 million people housed in multifamily dwellings across the country – with the sector contributing an estimated $1 trillion to the national economy annually.

The largest multifamily market outside of US is in Japan where there has been over $55 Billion USD in multifamily transactions over the last 10 years. Japan's largest homebuilder (Daiwa House) is estimated to currently own and rent out over 1.6 million dwellings – contributing enormously to the provision of rental accommodation across that country.

In Germany approximately 40 million people are housed in private rental accommodation – of which a large proportion of residential stock is owned and managed by institutional capital. Between 2010 and 2015 a total of $78.7 billion USD of institutional capital was invested in the residential sector in Germany – representing half of all capital invested in European residential property during this period.

While the Build-to-Rent residential sector in the UK is not as mature as in the US, Japan and Germany it is now emerging as a rapidly growing asset class – being driven by regulatory and economic changes. In a recent briefing note Emerge Capital suggest:

> *Parallels can be drawn between the historical limitations of Multifamily in the UK and those in Australia. In particular, government policies that favour home ownership/strata investment have crowded out institutional investors in both markets….To maintain investment in new housing, the Government is implementing a suite of recommendations from the Montague Report (2012) aimed at increasing institutional investment in the sector.*
> (Emerge Capital – Investment Highlight, March 2017)

Industry has been investigating the possibility of introducing Build-to-Rent products in Australia. We consider it has the potential to deliver significant benefits in the battle against deteriorating housing affordability across Australia.

5. Promoting Affordable Housing in Australia

UDIA welcomes incentives for investors to obtain capital gains discounts in affordable rental housing. We consider the incentivisation of affordable housing to be a key part of promoting the development of Affordable Housing across Australia.

While the legislation provides the opportunity for development of Affordable Housing we are concerned that removing the ability for MITs to invest in housing, other than Affordable Housing, will make it more challenging to deliver the returns necessary to secure investment, without significant government support.

In September 2017 the Council on Federal Financial Relations Affordable Housing Working Group identified Build-to-Rent as part of the most promising reforms to address the funding gap in delivering affordable housing.

> *Another emerging model in Australia (more common elsewhere in the world) is institutionally financed 'Build-to-Rent' models. Build-to-Rent relies on a developer (or consortium) building homes with the express intention of leasing them out long-term. Build-to-Rent models are used in many countries, including in the United Kingdom and United States, to provide affordable housing for low-income households.*
>
> *In the UK, large and sophisticated CHPs have structured Build-to-Rent deals directly with large property funds. For example, the Stratford Halo development comprises over 700 properties, housing a mixture of affordable rental and shared ownership as well as retail, commercial and leisure space. Community housing group and developer Genesis retained 299 units, selling the remaining 401 units to property fund M&G. Genesis then leased back the units for a term of 35 years managing the properties for a fee, paying M&G rent indexed annually by inflation, linking cash flows to their liabilities.*

Internationally, Build-to-Rent has supported the development of affordable housing. The Affordable Housing Working Group has identified it as an "area worthy of exploration as to its cost-benefit relative to other models." This would be a complementary reform to the affordable housing bond aggregator and the welcome capital gains discount for Affordable Housing, which would further boost Affordable Housing in Australia.

We consider it is premature to remove Build-to-Rent from the policy mix, before its potential to address Affordable Housing and affordable housing demands have been fully investigated by government and industry.

We would welcome the opportunity to meet with government and to discuss this draft policy further. In addition, we note that the consultation period for the draft legislation has been relatively short and would welcome the opportunity to undertake some in-depth scenario testing with our members – if afforded an extended window for response. Please don't hesitate to contact UDIA National as follows:

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