FSC
FINANCIAL SERVICES COUNCIL

5 October 2017

By email

Draft legislation relating to Managed Investment Trust investment in housing

The Financial Services Council (FSC) welcomes the opportunity to make submissions on the draft legislation to relating to Managed Investment Trust (MIT) investment in housing.

The FSC has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry is responsible for investing more than $2.7 trillion on behalf of 13 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

The FSC supports the government's stated goal of encouraging investment in affordable housing through MITs. However, the FSC does not support the proposal contained in the draft legislation to prevent MITs from acquiring residential property other than affordable housing.

The government states this proposal is 'clarifying' MITs are unable to invest in residential housing. The draft legislation indicates this 'clarification' is justified because "there is a view that investment in residential property is not made for a primary purpose of earning rental income. It is instead for delivering capital gains from increased property values and therefore not eligible for the MIT tax concessions."[1]

We do not agree with this argument. The statement that investment in residential property by all trusts is not made for a primary purpose of deriving rental income:

- inappropriately conflates the investment objectives of all investor and investment classes in relation to residential property. The investment objectives and outcomes of institutional investors in multi-family residential property assets should not be conflated with that of an individual investor in a single detached residential dwelling; and
- incorrectly implies that there is significant capital appreciation in residential property across all segments and markets.

For the reasons above we consider that the government's proposal is a change in the law, not a clarification.

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[1] Draft Explanatory Material, pp 26–27.

We consider this change to be both unhelpful and unnecessary. The existing law and accepted practice is not deficient; the assessment of whether a trust invests in land for the primary purpose of deriving rent should be undertaken on a case-by-case basis, noting that this does not require rent to be derived at all times.

This change could have a significantly adverse effect on collective investments in housing — also known as build to rent or multifamily housing. Collective investments in housing are the missing investment class in Australia, and are likely to be an important solution to Australia's housing affordability and supply problems. We do not consider that this change should occur outside of a more thorough inquiry into the potential for build to rent in Australia.

While the government is proposing a transitional period for MITs that held residential property as at 14 September, this does not adequately deal with transactions or developments that were underway but had not been completed.

In addition, there are many investments by Australian funds, offshore and locally, that involve some element of residential investment. This may for example include apartments above a shopping centre, generally referred to as 'mixed use' developments, which can sometimes be a requirement of a local council. In some cases the residential investment may be a very small part of the total investment; but the draft legislation would appear to deny MIT status for a fund that has even a tiny amount of residential investment. This approach, on the face of it, is unjust and excessive.

The FSC therefore recommends that the legislation be changed to remove the prohibition on MITs acquiring residential property other than affordable housing.

We are also concerned about the application of this measure to Australian MITs investing in foreign residential properties, such as in the US. Several FSC members currently hold these types of investments and will likely need to divest them under the proposed change. It appears that the exemption from the measure for affordable housing will not work outside of Australia, so the legislation will effectively prevent Australian MITs from investing in any residential property overseas.

We can see no clear policy reason for mandating this change in the way MITs invest overseas. An Australian MIT investing overseas in residential property has no effect on the housing market in Australia; and investing in overseas 'build to rent' and other residential property is likely to have important diversification benefits. This restriction also appears to be inconsistent with the policy rationale underpinning amendments to Division 6C of Part III of the *Income Tax Assessment Act 1936* as a consequence of *Tax Laws Amendment (2007 Measures No.5) Act 2007* which allowed Australian trusts to invest in certain foreign investments such as US Real Estate Investment Trusts.

Therefore, at the very least, we request that the legislation be amended to ensure that there is no change to the tax treatment of MIT investments in foreign housing.

We would be happy to discuss this submission; I can be contacted on (02) 9299 3022.

Yours sincerely,

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