There is a need for new D2R projects, which encompass social, affordable or multifamily housing and retirement villages. Supplied by Matthew Cridland

If the solution to housing affordability is increased supply, then GST rules for develop-to-rent (D2R) projects is a key part of the problem.

"New housing" generally refers to residential premises developed-to-sell (D2S).

However, there is a need for new D2R projects which encompass social, affordable or multifamily housing and retirement villages.

Multifamily developments, which are common in the US and UK, can add a large number of residences suitable for long-term leasing in desirable locations using funds sourced from institutional investors. If a state government wants to redevelop a precinct, there is also potential to combine social, affordable, multifamily and retirement village premises into one integrated D2R project.
Building new apartments and houses solely to rent should be given GST credits in the early stages to stimulate supply, argues K&L Gates partner Matthew Cridland. Supplied

In a D2S project, a new residence attracts GST when sold on completion. Developers factor this into their feasibilities. Crucially, full GST credits are available on all costs,
including for land and development costs. During construction, the ATO typically repays the credits as a monthly cash refund.

In a D2R project, GST does not apply to residential rents. Further, the sale of second hand residential premises that have been leased for more than 5 years does not attract GST. The catch is that full GST credits are not available for land and development costs, which is known as "GST leakage".

There is an exception to these general rules for social housing and retirement village projects undertaken by endorsed charities. For qualifying projects, endorsed charities are not liable for GST on rents and remain entitled to full credits on costs.

GST leakage has an adverse internal rate of return impact and can make new D2R projects unviable. It also creates an uneven playing field when developers are competitively tendering for a desirable site. For example, a developer planning a D2R project may bid $20 million (no credit available) for a site while a developer planning a D2S project may bid $22 million ($2 million credit available). The net cost to both developers is $20 million.

One particular GST anomaly is the concession for social housing. It is only available where the premises are owned and leased by an endorsed charity. If the premises are instead owned by a state agency, and leased by an endorsed charity on behalf of that agency, the concession is not available meaning the agency incurs GST leakage.

Where new social housing is supplied by a developer to an agency as part of a larger project, any GST leakage cost is invariably passed on to the developer. This reduces the funds the developer can spend on the social housing component. This is undesirable and the anomaly could be readily fixed.

New retirement villages are important for our aging population. They also aid housing affordability by providing purpose built "downsizing" options for seniors, freeing up existing stock. However, GST leakage makes it very difficult for developers to win desirable sites, while the further GST leakage on development costs can make development of a new village unviable.

The GST rules do currently provide a concession for long-term accommodation provided in "commercial residential premises" such as hotels, motels and hostels. Where available, the operator may elect to pay GST at a reduced rate of 5.5 per cent while remaining entitled to full credits on all costs. Developers constructing new student accommodation, which is akin to a hostel, already tap this concession whenever possible.

One option to reduce GST leakage for D2R projects is to extend the commercial residential premises concession to qualifying multifamily and retirement village developments. This would allow developers the option to elect to claim full GST credits on all costs, with GST then payable on rents over time at a rate of 5.5 per cent.
Alternatively, developers could be allowed to claim full credits initially, with the credits clawed back over an extended period (say, 10 years) or when the premises are sold (if earlier).

While other tax initiatives including negative gearing, CGT discounts and stamp duty concessions arguably fuel demand and increases prices, addressing GST leakage removes an impediment to new supply. In the 17 years since GST was introduced, the rules impacting D2R projects have not fundamentally changed. It is timely to review the rules and the impacts on new housing supply.

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