Tax Working Group Public Submissions Information Release

Release Document

September 2018

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27 April 2018

Tax Working Group Secretariat
PO Box 3724
Wellington 6140
New Zealand

SUBMISSION ON GST CHANGES TO ENCOURAGE AFFORDABLE HOUSING

Summary of our submission

- Charities and other registered not-for-profit housing entities who charge below market rents should be incentivised through the tax system to increase supply of affordable housing
- A GST rebate for new developments would be the most effective way of achieving this
- Currently a housing provider who charges below market rents is not able to receive Government support such as accommodation supplement to the same level that market rent providers are able to
- This translates to lower returns overall, which limits the amount of additional affordable housing the provider is able to develop
- Allowing for a GST rebate on new affordable housing development would be an effective way to rebalance this situation and encourage development of affordable housing by these providers.

Who are we?

The Manawatū Community Trust was established as a charitable trust in 2008 to manage and develop 205 rental units for older residents and those with disabilities in the Manawatū District. All of our tenants are either on NZ Superannuation or are receiving some form of Government benefit. In line with the objectives of our Trust Deed, we set our rents at below market rates in order to ensure that they are affordable for our tenants.

Why do we care about the tax system?

The *Future of Tax Submissions Background Paper* asked whether there was a case to change the tax system to promote greater housing affordability. We believe there is an opportunity to introduce a GST rebate as a way to encourage charitable and other registered not-for-profit housing entities to increase the supply of affordable housing in New Zealand.

The Manawatū is like many other regional areas in New Zealand in that the next 30 years will see unprecedented growth in the over-65 year old demographic. To cater for this growth in our region we will need to add approximately 50 additional units over the next 15 years, and another 30 to 40 in the 15 years after that. This is a significant challenge for a charitable trust that provides housing at affordable levels.

What limits us increasing supply right now?

Our returns from our rental accommodation are low, delivering approximately 2 to 3% net yield (before depreciation). This occurs because we charge rents at below market rates, setting them at the lower quartile level and within 27-30% of tenant income. While we make a cash surplus at these levels, this is not enough to cover depreciation (but is enough to cover refurbishment of existing accommodation). There is very little left over to fund borrowing to increase the level of supply.

We could increase our rents to market levels, giving us a higher cash surplus to invest in new supply. Our tenants would be able to access higher levels of Accommodation Supplement. However, our tenants would end up paying over 35% of their income in accommodation, which is well beyond standard measures of affordability. We would also be going against our trust deed which requires us to work for the relief of poverty and promotion of well being.

We could become a Community Housing Provider and access the Income Related Rents Subsidy. In cash terms this would have a similar impact to increasing to market levels. However, none of our tenants are on the social housing register and are therefore not eligible for IRRS. New tenants may be eligible, but then our existing client segment would not be catered for (or they would be catered for by others who charge market rates).

When we undertake commercial developments we are able to claim back the GST component of the build, since the rental revenue we receive on those developments include GST. That makes perfect sense to us.

When we undertake developments to extend our supply of affordable rental units we have to pay GST on the labour and materials. We cannot claim this GST back though, because the rent we charge on the units does not include GST. That makes sense for the general market, since it effectively gets priced in to the market rent and the investment decision. It does not make sense for affordable housing providers – we already take a knock by receiving lower income due to charging below market rates (making it affordable for tenants), and then this GST treatment skews it further by increasing the investment hurdle.

What could be changed?
Introducing a GST rebate on the development of new affordable housing supply by charities and other registered not-for-profit housing providers would be an effective way of resolving this issue. It would be a tidy mechanism compared to setting up administratively-heavy capital grants incentives. It would also complement, rather than conflict with, existing non-tax initiatives aimed at other segments of the housing market (such as IRRS being available when housing tenants from the social housing register).

We see the mechanism working in this way:

- As a charitable trust or other registered housing provider we would develop new affordable rental accommodation.
- GST on expenses for the development would be captured as an adjustment on our return.
- A matching amount would be recorded on our balance sheet as a liability.
- We would be required to make a declaration each year that the assets remain in use for affordable housing, and this declaration would be auditable (we could also be required to disclose this as part of our financial statements).
- If we sell the developed housing asset within a specified time period – say 5 years – then we would be required to pay the amount of the liability to the IRD.

- If we keep the developed asset for affordable housing for the required time period, then we would be allowed to write the liability off.

The housing provider must have a strong enough balance sheet to be able to carry impact of the GST amount for the specified time period (5 years in the example above). We believe this is necessary to ensure an element of sustainability in that providers will need to have sufficient assets to balance the carrying of this liability, and that the assets will continue to be used for the purposes of affordable housing.

What practical impact would this have?

Let's say the units we need to build are 50 square metre 1 bedroom units and can be built for a modest construction cost of $2,300 per square metre. This means the $4.6m we have available can be used to build 40 of the 50 units we need.

Simple maths shows that removing the GST brings the construction cost down to $2,000 per square metre, meaning we can build 46 units for the $4.6m we have.

However, since the builds are spread over 15 years (most likely evenly in blocks of 10 at a time), we may be able to take advantage of lower borrowing levels early on to squeeze another 1 or 2 units into the mix to reach up to 48 over the 15 year period. This will depend on whether the rebate is a contingent or other type of liability and how banks would factor this into their borrowing requirements.

These numbers sound small, but they only relate to one provider in regional New Zealand.

Conclusion and recommendations

We recognise that the Tax Working Group is likely to focus on the 'big' issues affecting housing affordability, such as the tax advantages available to private landlords.

This submission is to encourage the Group to consider some smaller changes that could help increase the supply of affordable housing by other segments of the housing market.

Our recommendation is that the Tax Working Group considers the use of a GST rebate as the mechanism to encourage increased supply of affordable housing by charitable organisations or other registered housing entities.

We are willing to speak to our submission or be contacted for additional information.

Yours sincerely,

Trustees of Manawatū Community Trust