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# Could Build-to-Rent be an ACT housing affordability measure?

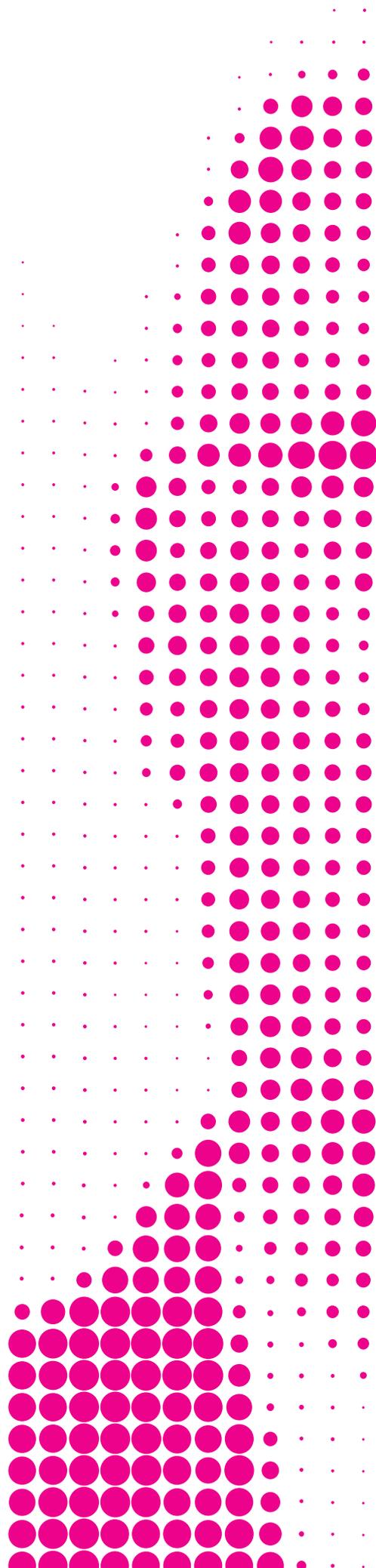
*Observations on the potential of the Build to Rent model to address affordability goals outlined in the ACT Housing Strategy (2018)*

By Cornelius Pau

*The Alastair Swayn Internship 2019: The Alastair Swayn Internship Program is a joint initiative between the Alastair Swayn Foundation, the ACT Government and the University of Canberra*



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## FINAL RESEARCH PAPER (Week 15)

Cornelius Pau

**Topic:** Observations on the potential of the Build to Rent model to address affordability goals outlined in the ACT Housing Strategy (2018).

### Abstract

Housing affordability is a critical issue across Australia and it is most pronounced in its eight capital cities, which accommodate 67% of the nation's population. Population growth, housing undersupply, and declining public expenditure on housing all contribute to the issue. The situation has been exacerbated within the last two decades as housing price increases overtook increases in household earnings. This resulted in housing continuing to grow beyond the reach of those on below to average incomes. In the capitalism paradigm, the pursuit of wealth has commodified the homes people live in and as such, poses a challenge for the provision of housing on an equitable footing. To ameliorate the need for quality housing with equitable access across its demographics, the ACT Government is seeking to fill the gap between those who qualify for public housing facilities and those who are able to own homes. One of the solutions it is examining to address its housing objectives, is the Build to Rent (BTR) model. This new asset class is supported by the Property Council of Australia (PCA) for introduction to the Australian market.<sup>1</sup> The intent of this research project is to conduct a literature review to ascertain if and how, the BTR model has had an effect on housing supply and affordability. It will consider research on BTR, policies where the model has been implemented in overseas jurisdictions, and how these could contribute to the housing objectives (Goals) set out in the ACT Housing Strategy (the Strategy), with particular regards to affordability.

### Background

The Australian Government makes a distinction between housing affordability and affordable housing. The former, being a relationship between expenditure on housing and household income whereas affordable housing is that catering to the "low income group"<sup>2</sup>. The latter is also described by the PCA as housing at "discounted market price"<sup>3</sup>. While the ACT Government has no formal definition for affordable housing, it sets parameters around eligibility for affordable housing and pricing thresholds.

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<sup>1</sup> Ken Morrison, Belinda Ngo, Rebecca Douthwaite, Property Council of Australia, "Submission: Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018," p1-26.

<sup>2</sup> Matthew Thomas, "Housing affordability in Australia," Australian Government, accessed September 2019, [https://www.aph.gov.au/About\\_Parliament/Parliamentary\\_Departments/Parliamentary\\_Library/pubs/BriefingBook45p/HousingAffordability](https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BriefingBook45p/HousingAffordability).

<sup>3</sup> Ken Morrison, Jane Fitzgerald, Rebecca Douthwaite, Property Council of Australia, "The Build-to-Rent Opportunity: Transforming the supply of residential rental housing in New South Wales", p26.

One of the ways to understand housing affordability is to compare either the average or median house price to the average or median household income<sup>4</sup>, respectively. In the early 1980s, when housing was considered affordable, median house prices equated to approximately three times the median household income<sup>5</sup>. However, by the first quarter of 2010 and again, in the last quarter of 2015, median dwelling prices were 6.5 times<sup>6</sup> household income. This clearly demonstrates the disproportionate increase in dwelling prices compared to increase in household income over those intervening three decades, leading to an adverse effect on housing affordability. While there are seasonal movements, dwelling prices have trended upward over the longer term.

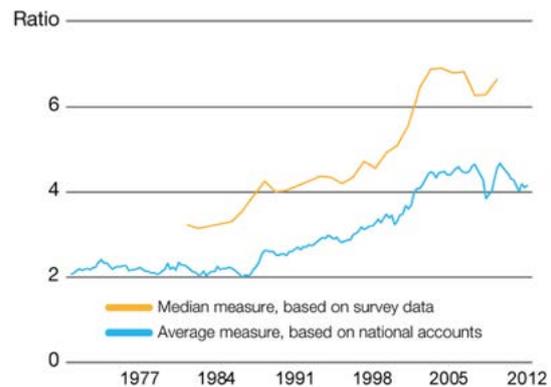


FIGURE 1-Ratio of Dwelling Price to Income, source: Fox & Finlay 2012

Another way of understanding affordability is a measure of housing expenditure as a proportion of weekly household income. For those whose income are in the bottom 40%, housing expenditures of more than 30% are considered to place them in 'housing stress'.<sup>7</sup> This relationship is a clearer indicator of housing cost for both ownership and rental as housing expenditures can be in the form of mortgage repayment or rent.

## ACT Housing Strategy and Rentals

Following extensive community consultation, the ACT Government published the Strategy in 2018, as guidance for ensuing housing policies in the decade ahead. The Strategy aims to 'provide an equitable approach to housing for all Canberrans now and into the future'<sup>8</sup>. Given that Canberra's average household income is above the national average, it may be perceived that this engenders greater housing affordability but it is not indicative of the housing prices in the Territory, which is among the highest in the nation.<sup>9</sup> In recognition of the latter and the housing stress brought about by high housing price for those on below average to low income,<sup>10</sup> the Strategy is focused on the first two income quintiles,<sup>11</sup> which range up to \$100k per annum.

The ACT Government has two sets of goals within the Strategy that relate specifically to affordable housing. One of these, is to increase affordable rental housing (Goal 4) and the other is to increase

<sup>4</sup> Ryan Fox and Richard Finlay, "Dwelling Prices and Household Income," Reserve Bank of Australia, *Bulletin* December Quarter 2012, p3, <https://www.rba.gov.au/publications/bulletin/2012/dec/pdf/bu-1212-2.pdf>.

<sup>5</sup> "Dwelling Prices and Household Income," RBA, *Bulletin* December Quarter 2012, graph 3, p.17, <https://www.rba.gov.au/publications/bulletin/2012/dec/pdf/bu-1212-2.pdf>.

<sup>6</sup> Shane Garrett, "Dwelling Prices: What's the current state of play?" *HIA Economics Research Notes* – August 2016, p5.

<sup>7</sup> "Housing affordability in Australia," Australian Government, [https://www.aph.gov.au/About\\_Parliament/Parliamentary\\_Departments/Parliamentary\\_Library/pubs/BriefingBook45p/HousingAffordability](https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BriefingBook45p/HousingAffordability), p4-5.

<sup>8</sup> "ACT Housing Strategy," ACT Government, released October 2018, <https://www.act.gov.au/homes-housing/act-housing-strategy/introduction>, p1

<sup>9</sup> Nerida Conisbee, "Australian Property Market Report," *realestate.com.au*, April 2019, <https://www.realestate.com.au/australian-property-market/property-report-april-2019/>.

<sup>10</sup> ACT Government, "Submission to Affordable Housing Working Group," p2.

<sup>11</sup> "ACT Housing Strategy," <https://www.act.gov.au/homes-housing/act-housing-strategy/vision-and-goals/goal-1>.

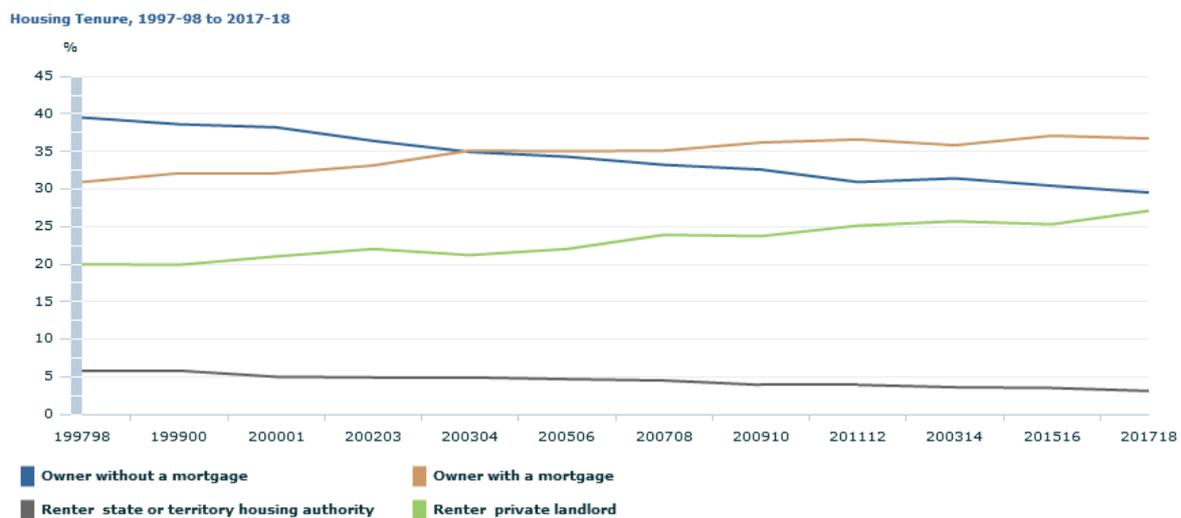
affordable home ownership (Goal 5). It has also articulated within Goal 1, a commitment to dedicate “15% of its annual Indicative Land Release Program to growing the supply of public, community and affordable home purchase homes. Equally, it will look to increase the supply of affordable and social housing on privately leased land through incentives and, where appropriate, with planning controls.”<sup>12</sup>

From observations, the government has focused on home ownership stipulated in Goal 5 but more recently, a Suburban Land Agency brief on an upcoming Affordable Housing review referred to investigations on BTR as a pathway for affordable rental<sup>13</sup>.

The objectives of the Strategy on affordable rental (Goal 4), are listed as follow:

- Grow and diversify the community housing sector;
- Grow the supply of affordable private rental properties;
- Strengthen rights and protections for tenants;
- Provide targeted advice and support to tenants and landlords; and
- Target programs to increase supply of affordable housing for vulnerable and disadvantaged households.

In the period between 1997-98 and 2017-18, the proportion of renters in Australia rose from 27% to 32% (refer graph below), which indicates an upward trend for this housing type. While social housing rentals declined from 6 to 3% in the same two decade period, private rentals increased from 20 to 27%<sup>14</sup>.



**Figure 2-Housing Tenure, 1997-98 to 2017-18, source:** Australian Bureau of Statistics (ABS) 2019

Despite Australia’s culture of home ownership, housing rentals are growing in significance as a part of the housing equation but this housing choice is also experiencing affordability issues.

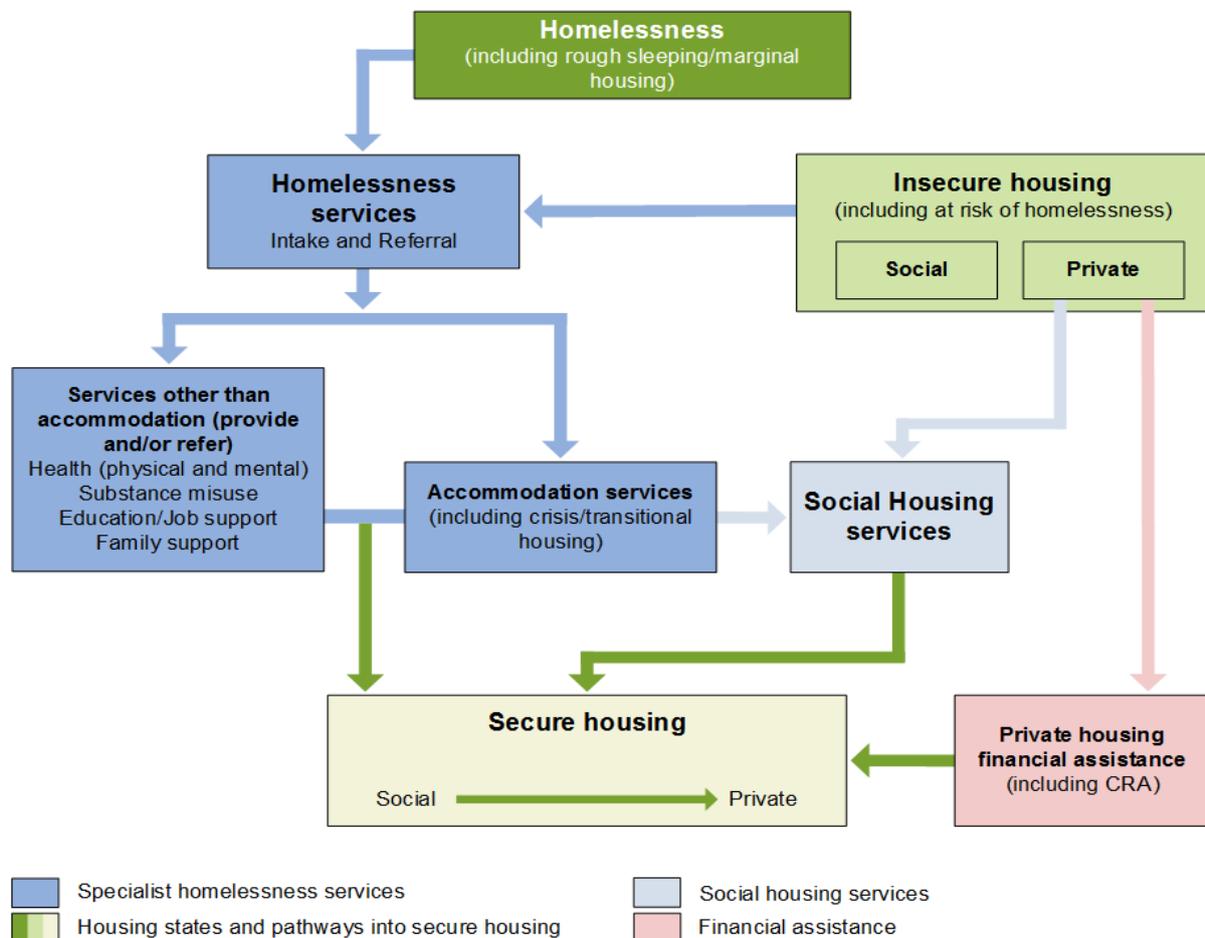
<sup>12</sup> “ACT Housing Strategy,” <https://www.act.gov.au/homes-housing/act-housing-strategy/vision-and-goals/goal-1>.

<sup>13</sup> Suburban Land Agency, “Affordable Housing Review,” Business Summary (Item 7.3), meeting 27 August 2019 (No. 34), paragraph 10, p3.

<sup>14</sup> Australian Bureau of Statistics, “4130.0 - Housing Occupancy and Costs, 2017-18,” released 17 July 2019, <https://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/4130.0~2017-18~Main%20Features~Housing%20Tenure~3>.

According to the Productivity Commission, of all households renting in the private sector in 2015-16, approximately 22.5% were in housing stress, that is their housing expenditure exceeded 30% of their gross household income.<sup>15</sup> Despite \$4.5b in Commonwealth Rent Assistance (CRA) in 2015-16<sup>16</sup> for those eligible in the private rental market and community housing,<sup>17</sup> 44.2% of CRA-recipient households continued to experience housing stress.<sup>18</sup> This situation was similar in 2017-18 with \$4.4b in rent assistance,<sup>19</sup> and 40.3% of CRA-recipients in housing stress.<sup>20</sup>

The path to secure housing includes rentals:



**FIGURE 3, source:** *Steering Committee for the Review of Government Service Provision, Report on Government Services 2019*, Figure G.1 Role of housing and homelessness sector services in pathways to secure housing

<sup>15</sup> "G. Housing and Homelessness" *Report on Government Services 2019*, Productivity Commission, revised 27 June 2019, <https://www.pc.gov.au/research/ongoing/report-on-government-services/2019/housing-and-homelessness>.

<sup>16</sup> "Table GA.5 Australian Government expenditure for Commonwealth Rent Assistance, 2013-14 to 2017-18 (2017-18 dollars) (\$million) (a), (b), (c), (d)," *Report on Government Services 2019*, <https://www.pc.gov.au/research/ongoing/report-on-government-services/2019/archive/housing-and-homelessness/rogs-2019-partq-sectorq-attachment.pdf>.

<sup>17</sup> "Commonwealth Rent Assistance," Department of Social Services, accessed 5 November 2019, <https://www.dss.gov.au/housing-support/programmes-services/commonwealth-rent-assistance>.

<sup>18</sup> "Table GA.2 Proportion of low income rental households in rental stress, by State and Territory, by location (a), (b), (c), (d), (e), (f), (g)," *Report on Government Services 2019*.

<sup>19</sup> "Table GA.5 Australian Government expenditure for Commonwealth Rent Assistance, 2013-14 to 2017-18 (2017-18 dollars) (\$million) (a), (b), (c), (d)," *Report on Government Services 2019*,

<sup>20</sup> "Table GA.2 Proportion of low income rental households in rental stress, by State and Territory, by location (a), (b), (c), (d), (e), (f), (g)," *Report on Government Services 2019*.

## Build to Rent (BTR)

BTR is typically an apartment block that is constructed specifically for the purpose of generating long-term rental revenue. Characteristically, it is owned by a single institutional owner, offers additional amenities such as a gymnasium, cinema, child care, roof terrace etc, and is professionally managed.

This model differs from the traditional Build to Sell approach in a number of ways including:

- the BTR developer or investor is not required by a financial institution to sell a percentage of the development off-the-plan to secure the capital;
  - private capital maybe raised through investment trusts;
- On completion, ownership is not transferred to individuals but instead, the developer retains ownership or the development is transferred to an institutional owner;
  - along with continuing ownership, for-profit owners of BTR are liable for land taxes and are ineligible for Goods and Services Tax credits.

To attract institutional capital investments to BTR, the PCA is advocating for the following changes to the Australian Government taxation framework<sup>21</sup> to:

- lower a Managed Investment Trust's (MIT's) withholding tax rate for residential property from 30% to 15%, making it consistent with withholding tax rates for other institutional real estate investments;
- set an MIT's withholding tax rate for affordable housing components of BTR at 10%, as a trade-off for the lower return on affordable rentals; and
- introduce an additional 10% Capital Gains Tax discount for affordable housing components of BTR in conjunction with the above incentives, as it will be ineffective if introduced in isolation.

While its clientele is restricted to students, purpose built student accommodation (PBSA) is an antecedent to the BTR. PBSA is underpinned by government support with the use of "guaranteed income agreements"<sup>22</sup> and the National Rental Affordability Scheme (NRAS) allocations. PBSA offers possible lessons for the implementation of BTR in how it is financed and operated. The following four PBSA models<sup>23</sup> have been utilised at Australian universities:

- Build, own, operate and transfer (BOOT) – a public-private partnership arrangement with the development built and operated by private providers on long-term land lease from the university. On lease expiry, ownership of the PBSA is transferred to the university;
- Develop, strata and manage (DSM) – individual investors own a strata development which is then leased to an operating entity for PBSA use only;
- Management-only providers – private provider partners with developer or university to operate the PBSA facility under contract; and
- Wholly integrated providers – the facility is developed and managed in-house for long-term use.

Other BTR antecedents include social housing, and homes provided by the Defence Housing Authority.<sup>24</sup>

<sup>21</sup> Morrison et al, Property Council of Australia, "Submission: Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018," p24-25.

<sup>22</sup> Hal Pawson et al, UNSW, and Kristian Ruming et al, Macquarie University, "2. The Emergence of build-to-rent in Australia," in *Build to rent in Australia: Product feasibility and affordable housing contribution*, (Sydney: Landcom, 2019), p37.

<sup>23</sup> Pawson et al, UNSW, Ruming et al, Macquarie University, "2. The Emergence of build-to-rent in Australia," p37.

<sup>24</sup> Pawson et al, UNSW, Ruming et al, Macquarie University, "2. The Emergence of build-to-rent in Australia," p40-41.

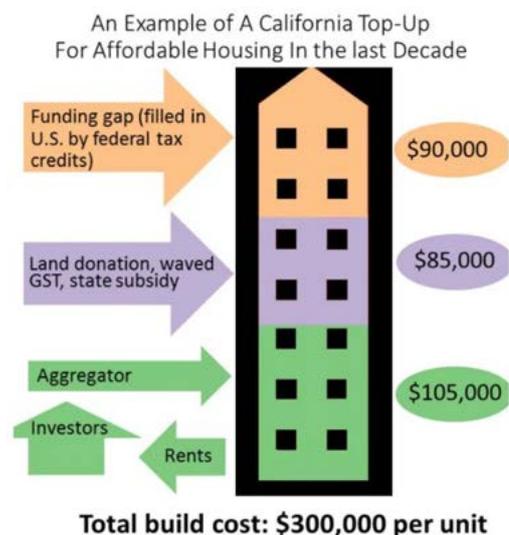
## BTR in overseas jurisdictions

The UK with historical ties to, and a legacy in Australia, presents a relatable exemplar for consideration on the introduction of BTR. From its 2017 housing White Paper, *Fixing our Broken Housing Market*, it is evident that the UK shares similar housing issues, only to a different extent that is experienced in Australia.

The common issues are the housing undersupply with the most acute situation being in London, and major cities like Lancaster, Manchester and Boston,<sup>25</sup> and where the increases in housing price have outstripped increases in income. In 2015, in London, the median house price was over 14 times that of median income.<sup>26</sup> By comparison in Australia, the relationship between median house price to median income appeared to have reached a peak at a ratio of over 10 times, in late 2015, in Sydney<sup>27</sup>. The White Paper indicated a doubling in the UK rental market in the previous decade.<sup>28</sup> It further emphasised a rise from 29 to 37% in the rental segment comprising households with dependent children.<sup>29</sup> The latter was a policy impetus to provide more stable rental in the form of BTR to this segment and BTR has also been held up as a way of addressing affordable rental<sup>30</sup>.

Prior to the White Paper, in 2012, the UK had reviewed the impediments to institutional investments in the private-rental market. As a response, and to kickstart BTR implementation, the UK Government stimulated private investments with a £1b Build to Rent Fund and a £3.5b Private Rented Sector Housing Guarantee Scheme<sup>31</sup>. Once institutional capital was mobilised, the UK achieved successes in improving housing supply, with March 2018 figures from the PCA suggesting that 15,925 BTR units had been completed and another 20,618 more units under construction.<sup>32</sup>

In the United States (US), the BTR has been a part of its housing landscape for some decades. There, BTR is referred to as a *multi-family* and a significant portion of the American housing diversity<sup>33</sup>. Much of the multi-family developments are by the private sector. It is notable that the American model recognised the inadequacy of private funding for both the development and operation of



**FIGURE 4, source:** Matthew Palm, *The Conversation*, "Build to rent could be the missing piece of the affordable housing puzzle," 29 August 2017. Amendment noted by Palm - total unit build cost in example should be \$280k.

<sup>25</sup> "Fixing our Broken Housing Market," UK Government, presented to British Parliament 2017, <https://www.gov.uk/government/publications/fixing-our-broken-housing-market>, p11.

<sup>26</sup> "Fixing our Broken Housing Market," Figure 3, p12.

<sup>27</sup> Garrett, "Dwelling Prices: What's the current state of play?" *HIA Economics Research Notes* – August 2016, p5.

<sup>28</sup> "Fixing our Broken Housing Market," p50.

<sup>29</sup> "Fixing our Broken Housing Market," p56.

<sup>30</sup> "Fixing our Broken Housing Market," p50.

<sup>31</sup> "Fixing our Broken Housing Market," p50.

<sup>32</sup> Morrison et al, Property Council of Australia, "Submission: Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018," p18.

<sup>33</sup> Jake Wegmann and Alex Schfran, "A New Perspective on Housing Tenure," posted September 28, 2016, <https://shelterforce.org/2016/09/28/a-new-perspective-on-housing-tenure/>.

apartment housing facilities. This “housing funding gap”<sup>34</sup> is filled in by the federal government (refer figure 4).

A US national tax incentive since 1986, the Low Income Housing Tax Credit (LIHTC), is said to be instrumental in attracting up to US\$100b in private investments to develop almost 3 million affordable rentals<sup>35</sup>.

Also, mandatory inclusionary zones are used in a number of US cities to “impose ‘affordable housing’ obligations on private developers,” while in the UK, local councils have the support of a national framework known as S106 agreements, to negotiate inclusionary requirements with developers.<sup>36</sup>

### Advantages and Disadvantages of BTR

A growing interest for BTR to increase Australian housing stock have been fuelled by BTR successes enjoyed overseas coupled with similarities of local Australian housing conditions to those jurisdictions, the growing significance of rental as both housing choice and necessity, and the tightening of credit availability or lending restrictions<sup>37</sup> despite having the lowest cash rates in history.

Gross income	Basic living expense	Basic borrowing limit	Lavish living expenses	Lavish borrowing limit
\$80,000	32,400	337,985	\$50,000	\$195,912
\$100,000	32,400	484,315	\$58,320	\$327,000
\$125,000	32,400	643,892	\$68,320	\$465,615
\$150,000	32,400	817,340	\$78,320	\$538,622
\$200,000	32,400	1,144,225	\$88,320	\$792,804
\$500,000	32,400	3,141,171	\$108,320	\$2,472,763

**FIGURE 5, source:** 2018 ABC - “Borrowing crackdown could mean an \$80k income makes you eligible for a \$200k loan,” <https://www.abc.net.au/news/2018-04-06/homebuyers-tougher-borrowing-rules/9626318>

The PCA which is actively advocating for Federal level taxation changes for the introduction of BTR in Australia, has indicated that the BTR form of housing supply smooths out the surges normally experienced with Build to Sell cycles.<sup>38</sup>

<sup>34</sup> Matthew Palm, *The Conversation*, “‘Build to rent’ could be the missing piece of the affordable housing puzzle,” updated 29 August 2017, <https://theconversation.com/build-to-rent-could-be-the-missing-piece-of-the-affordable-housing-puzzle-82320>.

<sup>35</sup> Pawson et al, UNSW, Ruming et al, Macquarie University, “5. BtR, affordable housing and the possible roles of community housing providers,” p92.

<sup>36</sup> Pawson et al, UNSW, Ruming et al, Macquarie University, “5. BtR, affordable housing and the possible roles of community housing providers,” p91.

<sup>37</sup> Australian Broadcasting Corporation, “Borrowing crackdown could mean an \$80k income makes you eligible for a \$200k loan,” ABC News, updated 7 April 2018, <https://www.abc.net.au/news/2018-04-06/homebuyers-tougher-borrowing-rules/9626318>.

<sup>38</sup> Morrison et al, Property Council of Australia, “Submission: Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018,” p5.

For renters, the BTR is purported to bring a range of benefits. As BTR is purpose built for rental and owned by institutional investors, one of its main benefits is stability in long-term tenure,<sup>39</sup> suiting those with dependent children or those who are transient with their occupations.

One of the benefits often mentioned in support of BTR is its location in close proximity to public transport corridors and urban areas with employment opportunities and easy access to services.<sup>40</sup> This is imbued with both social and environmental benefits. However, arguably the decision for these locations would be subject to availability as such locations are not infinite, and not all developer and/or investors may be able to access the capital to fund the premium that these sites command.

Other benefits touted by proponents of BTR, also include higher quality construction including mechanical appliances, window treatments, fixtures and fittings as these result in lower operating costs.<sup>41</sup> These seem to be rational propositions and the benefits are appealing as they project environmental benefits in reducing consumption and carbon emissions. However, it is doubtful if there is evaluative data or information to substantiate these decisions as compared to a developer doing it 'on the cheap'.

Refer Attachment A for a summary of advantages and disadvantages of BTR.

## ACT Rental Context

Within the ACT context, of "low-income households" that rented privately in 2015-16, 33.8% or 8,672 households out of 25,620 experienced housing stress.<sup>42</sup> While the \$34.3m in CRA funding for the ACT in 2017- 18<sup>43</sup> ameliorated housing stress for some recipients, 47.9% of recipient households continued to experience housing stress.<sup>44</sup>

As at September 2019, Canberra's median house rent at \$550 per week was the highest in the nation, while its median unit rent at \$470 per week is only behind Sydney's rental market. Exacerbating the situation, the vacancy rate for rental properties across Canberra in this period was 1.1%.<sup>45</sup> In the public housing sector, there has been a 61% increase in demand over the last year (from 1178 applicants in 2017-18 to 1899 applicants in 2018-19) and a 30% increase in the waiting list over the preceding 18months with the current waiting time for placement, for standard applications being over 3 years.<sup>46</sup>

This situation underscores the dire need to deliver affordable rentals in the ACT, which is clearly an objective of the ACT Government as articulated in Goal 4 of the Strategy.

<sup>39</sup> Morrison et al, Property Council of Australia, "Submission: Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018," p10.

<sup>40</sup> Morrison et al, Property Council of Australia, "Submission: Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018," p11.

<sup>41</sup> Rebecca Douthwaite, phone conversation with author, 19 September 2019.

<sup>42</sup> "Table GA.2 Proportion of low income rental households in rental stress, by State and Territory, by location (a), (b), (c), (d), (e), (f), (g)," *Report on Government Services 2019*, <https://www.pc.gov.au/research/ongoing/report-on-government-services/2019/archive/housing-and-homelessness/rogs-2019-partg-sectorg-attachment.pdf>.

<sup>43</sup> "Table GA.5 Australian Government expenditure for Commonwealth Rent Assistance, 2013-14 to 2017-18 (2017-18 dollars) (\$million) (a), (b), (c), (d)," *Report on Government Services 2019*.

<sup>44</sup> "Table GA.13 Proportion of income units receiving CRA, paying more than 30 per cent of income on rent, with and without BRA, by special needs, 2018 (per cent) (a), (b), (c)," *Report on Government Services 2019*.

<sup>45</sup> "What's happened to house and unit rents in your capital city?" *Domain Rental Report*, September 2019, <https://www.domain.com.au/research/rental-report/september-2019/>

<sup>46</sup> Dan Jarvis-Bardy, "Housing crisis deepens," *The Canberra Times*, 29 October 2019

## Final Observations: Issues and Possible Steps towards Affordable Housing using the BTR model

While it is beyond the scope of this research paper to make recommendations on the delivery of affordable housing by the ACT Government, there are a number of issues the Government may wish to investigate to progress this delivery.

It is generally accepted that the level of housing expenditure should not exceed 30% of gross household income to avoid housing stress. However, the demands on gross income can vary significantly from one household to another.<sup>47</sup> A formal definition for affordable housing including affordable rentals could be of value in guiding and evaluating the delivery of these policy objectives and practices.

According to the PCA, recognising its role as an industry advocate, “a successful build-to-rent sector is the best platform for industry to partner with Government to supply residential rental accommodation to lower income households.”<sup>48</sup>

Given that BTR is a departure from the traditional Build-to-Sell and a new asset class, it requires a level of restructure to Federal and state/territory-level taxation and planning frameworks to facilitate its introduction into the Australian housing market. To the institutional investor, BTR is an option to diversify their real estate portfolio. As such, for BTR to compete on an even footing with other real estate asset classes, comparable tax incentives or cash subsidies are required to attract the required capital. Within this context, the challenge to attract private institutional investment to BTR as a competitive proposition, if met, will achieve increased housing supply. However, the development of BTR with private capital as an affordable rental pathway under existing Australian Federal taxation policies seems limited.

Inclusionary zoning and tax incentives such as the LIHTC program in the US, and contractual obligations and government incentives in the UK, provide the required framework for private institutional investments in BTR to achieve affordable rentals in those overseas jurisdictions.

Similarly, the ACT Government could leverage the incentives and subsidies within its authority to achieve its affordable housing goals. This could emulate albeit with adaptations, incentives employed by such highly privatised economies as the US and UK. In the ACT, these maybe through the provision of discounted land, incentivising state-level tax<sup>49</sup> and lease variation arrangements, and formalising an inclusionary zoning policy<sup>50</sup> (refer to the following section, Discussion Issues).

Aside from incentivising private investments, a Landcom research paper concluded that BTR can be used to deliver affordable rental in a cross-subsidy arrangement such as in a mixed tenure, with 50% at market rent and 50% at below market rent, by non-profit developers.<sup>51</sup> The viability of this arrangement is predicated on the tax status of non-profit developers such as community housing providers.

Further bolstering a non-profit developer’s position to deliver affordable rentals with BTR facilities, are the recently announced low interest rate loans (less than 3%) offered as the \$314m social bonds offered by

<sup>47</sup> “About affordable rental housing,” NSW Department of Communities & Justice, accessed 9 November 2019, <https://www.facs.nsw.gov.au/providers/housing/affordable/about/chapters/what-is-affordable-housing>

<sup>48</sup> Morrison et al, Property Council of Australia, “Submission: Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018,” p15.

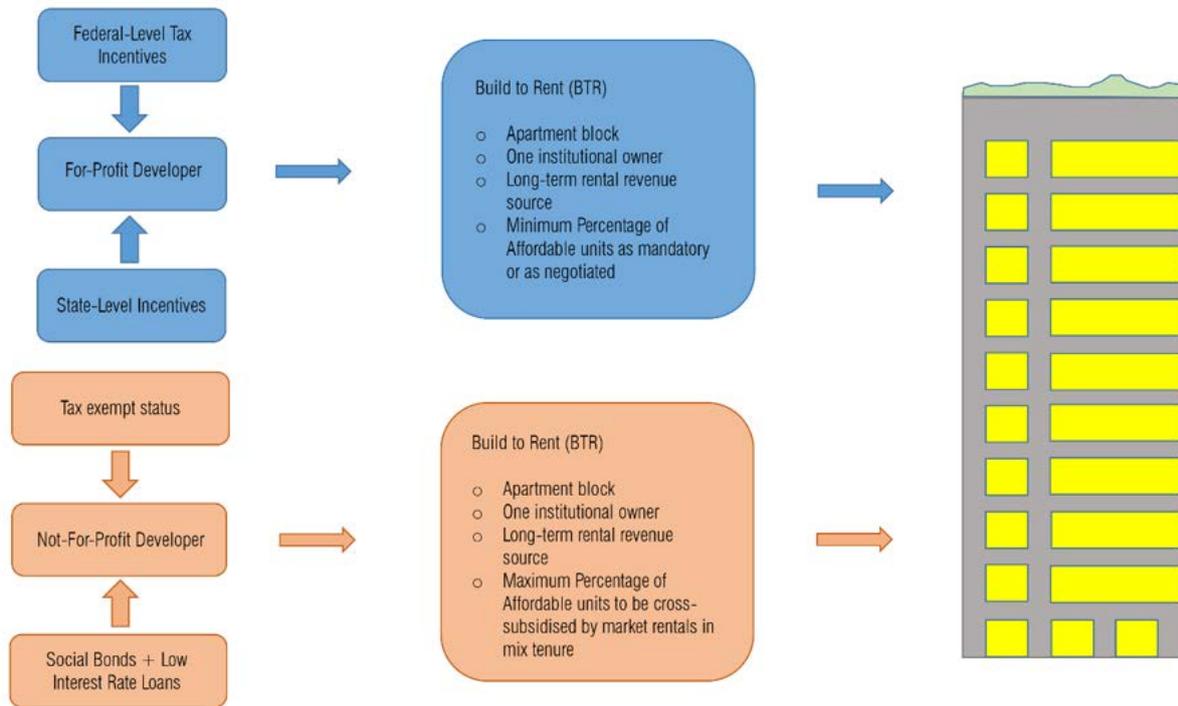
<sup>49</sup> Pawson et al, UNSW, Ruming et al, Macquarie University, “4. Build to Rent policy levers,” p74.

<sup>50</sup> “Understanding Inclusionary Zoning,” AHURI, Updated 17 March 2017. <https://www.ahuri.edu.au/policy/ahuri-briefs/Understanding-inclusionary-zoning>.

<sup>51</sup> Pawson et al, UNSW, Ruming et al, Macquarie University, “Executive Summary,” p17.

the National Housing Finance and Investment Corporation.<sup>52</sup> Even more recently, the National Australia Bank (NAB) has pledged \$2b in funding and services to non-profit developers for the provision of affordable housing including the development of BTR.<sup>53</sup>

As discussed earlier, the PBSA experience in Australia offers a number of procurement methods that could be used to deliver affordable housing in BTR developments.



**Diagram:** Delivery of BTR & affordable rental by For Profit Developer vs Not-for-Profit Developer

The extent to which BTR would be able to deliver on the affordable rental objectives as set out in Goal 4 of the ACT Housing Strategy is subject to the ACT Government’s risk appetite and guided by its broader economic, social and environmental policies.

<sup>52</sup> Luke Michael, “Australia’s largest social bond tackles affordable housing shortage,” *Probono*, 25 March 2019, <https://probonoaustralia.com.au/news/2019/03/australias-largest-social-bond-tackles-affordable-housing-shortage/>.

<sup>53</sup> Hannah Dowling, “NAB to provide \$2bn for affordable housing,” *Smart Property Investment*, 14 October 2019, <https://www.smartpropertyinvestment.com.au/finance/20180-nab-to-provide-2bn-for-affordable-housing>.

## Discussion Issues

### *How long will a BTR development be managed as rental housing?*

The LIHTC program in the United States requires developers to provide affordable housing for a “compliance period” in return for tax credits that can be claimed over 10 years. The initial compliance period is 15 years but an “extended use period” can be at least another 15 years and is variable in each state. Any non-compliance within the compliance period is subject to tax credit re-capture, which poses a disincentive<sup>54</sup> This limited period of affordable housing provision contrasts with that in the UK where affordable housing is a planning obligation set out in a S106 agreement. The obligation is imposed by the local authority on the developer but passes to any new owner and as such, it is an obligation that applies in perpetuity.<sup>55</sup>

In the case of for-profit BTR in Australia, the decision will be influenced by economic factors eg. business model for funding and operating the BTR, capital growth, growth of rent, whether the development is suitable for strata subdivision and housing demand cycle.

The ACT Government may wish to consider establishing inclusionary zoning or planning covenants to ensure a minimum period of time where the BTR facility will be maintained solely for the purpose of rental housing.<sup>56</sup> If procured as a BOOT (Build, Own, Operate, Transfer) model or a public-private partnership procurement method where the land is leased from the Government, the contract will incorporate expiration or termination clauses etc (refer to Purpose Build Student Accommodation developed with a BOOT model).

### *Will a BTR development have dedicated affordable stock?*

Based on the UK experience, there is no dedicated affordable stock<sup>57</sup> within a BTR facility ie. less desirable units with poor solar orientation or lack of views are not pre-designated as affordable units. The formalised arrangements using S106 agreements only requires provision of a percentage of apartments at below-market rent to eligible households.<sup>58</sup> BTR facility operators are also required to “report annually to the local authority on who has been living in affordable units”.<sup>59</sup> However, the allocation of units is a process managed at the local level by facility operators.

The ACT Government may wish to consider annual performance evaluation on for-profit BTR developments and correlating some incentives to meeting key targets.

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<sup>54</sup> Neal Hefferren, “A Complete Guide to the Low-Income Housing Tax Credit Program,” *Property Metrics*, updated on June 13, 2017, accessed on November 9, 2019, <https://propertymetrics.com/blog/a-complete-guide-to-the-low-income-housing-tax-credit-program/>.

<sup>55</sup> York, New Yorkshire and East Riding Strategic Housing Partnership, “Section 106 (S106) Agreements And Community Infrastructure Levy (CIL) Frequently Asked Questions April 2017”, accessed on 9 November 2019, <http://www.nykyerhousing.co.uk/housing-strategy/section-106-fags-agreements/>.

<sup>56</sup> Pawson et al, UNSW, Ruming et al, Macquarie University, “3. The BtR concept: Australian interpretations and their feasibility,” p54.

<sup>57</sup> Pawson et al, UNSW, Ruming et al, Macquarie University, “5. BtR, affordable housing and the possible roles of community housing providers,” p92.

<sup>58</sup> Pawson et al, UNSW, Ruming et al, Macquarie University, “5. BtR, affordable housing and the possible roles of community housing providers,” p91.

<sup>59</sup> Pawson et al, UNSW, Ruming et al, Macquarie University, “5. BtR, affordable housing and the possible roles of community housing providers,” p92.

*What is affordable rental?*

In the UK, affordable rental is defined in Annex 2 of the National Planning Policy Framework as “housing let by local authorities or private registered providers of social housing to households who are eligible for social rented housing. Affordable Rent is subject to rent controls that require a rent of no more than 80% of the local market rent (including service charges, where applicable).”<sup>60</sup> There is some flexibility to offer a smaller percentage of affordable units in a BTR development for a larger discount.<sup>61</sup>

Whereas in the US, rent for a unit in the LIHTC program is derived from a locality’s area median gross income (AMI), published annually by the federal Department of Housing and Urban Development. The calculation of gross rent, which covers both rent and utilities, is based on the tenants’ household income bracket within the AMI and the number of bedrooms in their rented unit. For examples of these calculations, refer to “How to Calculate Maximum LIHTC Rents: Gross Rent vs. Net Rent.”<sup>62</sup> Essentially, the maximum gross rent is limited to 30% of the household income. Affordable rent in the US model is heavily regulated.

In NSW, affordable rental rates are set by affordable housing managers in two ways:

- (i) discounts ranging from 20-25% below market rentals; and
- (ii) as a proportion (25-30%) of gross household income.<sup>63</sup>

*Would a BTR development meet a different set of building design requirements?*

The Property Council of Australia has advocated for the following changes, among others, to the NSW Government’s SEPP65 (*State Environmental Planning Policy No 65 - Design Quality of Residential Apartment Development*):

- “Relax the timeframe for apartments to require a minimum number of direct sunlight to between 8am and 4pm. Recognise and accommodate site limitations that prevent a minimum of 70% of apartments receiving a minimum number of sunlight hours given that a quality living experience can be achieved when underpinned by greater amenity and/ or common open space;
- Reduce the proportion of apartments that require minimum sized private open space (balconies) given the increased share of amenities available; and
- Relax the minimum 50% internal storage requirement to allow up to 75% being provided outside the physical apartment to allow greater flexibility in meeting renter’s needs.”<sup>64</sup>

These particular changes if presented to the ACT Government, would need to be carefully considered to ensure the quality of building design is not eroded.

<sup>60</sup> “Strategic Housing Partnership: Section 106 (S106) Agreements And Community Infrastructure Levy (CIL) Frequently Asked Questions April 2017,” York, New Yorkshire and East Riding, accessed on 9 November 2019, <http://www.nycyerhousing.co.uk/housing-strategy/section-106-fags-agreements/>.

<sup>61</sup> Pawson et al, UNSW, Ruming et al, Macquarie University, “5. BtR, affordable housing and the possible roles of community housing providers,” p92.

<sup>62</sup> “How to Calculate Maximum LIHTC Rents: Gross Rent vs. Net Rent,” Westmont Advisors, accessed 10 November 2019. <https://westmontadvisors.com/tax-credit-advisory/how-to-calculate-maximum-lihtc-rents/>

<sup>63</sup> “Renting Affordable Housing,” NSW Department of Communities and Justice, published 12 February 2018, <https://www.facs.nsw.gov.au/housing/help/ways/renting-affordable-housing>.

<sup>64</sup> Rebecca Douthwaite (Property Council of Australia, National Policy Manager), email to author, 17 September 2019.

*What are some state-level incentives and planning levers to facilitate a BTR development?*

Both the UK and the US use inclusionary zoning to mandate and incentivise the development of affordable housing including rentals. The S106 agreement is used by the London authority to achieve a 35% affordable housing target<sup>65</sup> with 60% of this to be provided as social or affordable rentals.<sup>66</sup>

Stakeholders interviewed in Landcom's research paper, overwhelmingly indicate that land tax exemption is the single most critical consideration for BTR's viability.<sup>67</sup> This is due to the nature of BTR's ownership which remains with a single institutional entity that is liable for land tax for the whole development. Compare this with a traditional Build to Sell apartment building owned by a multitude of investors who are individually liable for a share of land tax pertaining to their investment. The tax is also an annual liability for the entire duration of the BTR facility.

ACT Government is running a pilot program of land tax exemptions until 30 June 2021 for up to 100 properties registered as affordable rentals. It is of note in the context of not-for-profit BTR developments, that land owned by Community Housing Providers are exempt from land tax in the ACT.<sup>68</sup>

Another state-level lever is stamp duty, which is a one-off liability incurred early in the development of BTR when the land is purchased by the developer. Stamp duty changes are viewed by developers interviewed in the Landcom research paper as a lesser "priority than changes to land tax, MITs and GST settings."<sup>69</sup>

If exemption from these taxes are used to incentivise BTR developments, these incentives may be perceived as a loss of revenue to the ACT Government but economic modelling could be undertaken to ascertain if productivity gains and social savings enjoyed by the Territory from ensuring its communities attain secure housing outweigh these revenue losses.

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<sup>65</sup> Robert Booth, "London mayor sets 35% affordable homes target in deal with developers," *The Guardian*, 29 November 2016, <https://www.theguardian.com/uk-news/2016/nov/29/london-mayor-sadiq-khan-35-affordable-homes-target-deal-developers>.

<sup>66</sup> "Policy 3.11 Affordable housing targets," Mayor of London, accessed 11 November 2019, <https://www.london.gov.uk/what-we-do/planning/london-plan/current-london-plan/london-plan-chapter-3/policy-311-affordable>.

<sup>67</sup> Pawson et al, UNSW, Ruming et al, Macquarie University, "4. Build to Rent policy levers," p73-76.

<sup>68</sup> "Land Tax: 6. Exemptions," ACT Revenue Office, accessed 8 November 2019, [https://www.revenue.act.gov.au/land-tax?result\\_1060955\\_result\\_page=6](https://www.revenue.act.gov.au/land-tax?result_1060955_result_page=6).

<sup>69</sup> Pawson et al, UNSW, Ruming et al, Macquarie University, "4. Build to Rent policy levers," p77.

Federal-Level Incentives (as advocated by Property Council):

- Achieve parity with-holding tax rate of 15% for residential as for other real estate investments
- MIT with holding tax rate of 10% for affordable rentals as a trade off for lower returns
- 10% capital gains tax discount for affordable housing components of BTR in conjunction with above tax incentives

State-Level Incentives and Levers:

- Inclusionary Zoning to extend to affordable rentals and (possibly) to apply in perpetuity
- Land tax concessions or exemption
- Discounted Land Value
- Stamp duty concessions or exemption
- Lease Variation Charge concessions or exemption to encourage acceptable level of density

*What is an MIT and who does withholding tax apply to?*

Managed Investment Trusts (MIT) is a complex investment structure to enable financing of large projects. The MIT type that invests in real estate is referred to as Real Estate Investment Trust (REIT). These structures are well established in Australia and are used for large scale commercial properties. MITs pay less tax on their income than other Australian companies which are liable up to 30% of their profits.<sup>70</sup>

Foreign investors are liable for withholding tax on their income from an MIT or REIT.<sup>71</sup>

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<sup>70</sup> Pawson et al, UNSW, Ruming et al, Macquarie University, "2. The Emergence of build-to-rent in Australia," p42.

<sup>71</sup> Pawson et al, UNSW, Ruming et al, Macquarie University, "2. The Emergence of build-to-rent in Australia," p42.

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## Attachment A

## Summary of Build to Rent Advantages &amp; Disadvantages

FOR	AGAINST
Institutional ownership <ul style="list-style-type: none"> <li>more responsive to repairs and maintenance calls</li> </ul>	May be process-driven
Long-term lease arrangement is more conducive to placemaking	<ul style="list-style-type: none"> <li>Consistent long-term housing cost may diminish financial capacity in other areas such as health for ageing tenants</li> <li>May not be an option to buy</li> </ul>
Developer / Investor has commitment to property as long-term revenue source: <ul style="list-style-type: none"> <li>Addition amenities</li> <li>Lower operational outcomes</li> <li>Higher quality fittings and fixtures</li> </ul>	Developer / Investor may <ul style="list-style-type: none"> <li>seek to recover costs of higher quality outcomes with higher rent</li> <li>opt for a shorter-term economic outcome eg. sell the BTR facility if housing demand cycle shifts away from rentals</li> <li>lower operational costs may drive lower quality outcomes</li> </ul>
Developers can provide BTR facility in inner city locations or adjacent to transport corridor	This is a discretionary decision on the part of the Developer subject to availability of capital including land, and return from investment ie. if Build to Sell returns a higher yield for a particular site
Provides new investment opportunity	<ul style="list-style-type: none"> <li>Federal-level taxation does not offer comparable incentives for investors in residential real estate eg. BTR as other institutional real estate investments.</li> <li>Some developers claim that profit from Build to Rent is not enough to entice them eg. Caydon (Joe Russo)<sup>72</sup></li> </ul>
UK and US experiences provide examples of BTR successes	Need to develop both Federal and State/Territory level adaptations for Australian context
For-Profit BTR will increase housing supply and diversity	Provision of affordable housing through for-profit BTR development is limited without Government leadership at various levels

<sup>72</sup> Larry Schlesinger, "Build-to-rent will struggle in Australia: Joe Russo," *Australian Financial Review*, 5 September 2017, <https://www.afr.com/property/residential/buildto-rent-will-struggle-in-australia-joe-russo-20170904-gyabk2>.

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**Figure 3:** SCRGSP (Steering Committee for the Review of Government Service Provision) 2019, *Report on Government Services 2019*, Productivity Commission, Canberra, <https://www.pc.gov.au/research/ongoing/report-on-government-services/2019/housing-and-homelessness>

**Figure 4:** Matthew Palm, *The Conversation*, “Build to rent could be the missing piece of the affordable housing puzzle,” 29 August 2017, <https://theconversation.com/build-to-rent-could-be-the-missing-piece-of-the-affordable-housing-puzzle-82320>

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