



**Submission to the
Commonwealth Government's review of
Australia's Future Tax system**

March 2009

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1. The NSW Federation of Housing Associations

The NSW Federation of Housing Associations (the Federation) is the industry peak body for housing associations in NSW.

Housing associations are not-for-profit community housing providers whose principal business is managing and developing long term housing for low and moderate income households.

Housing associations manage 18,100 properties, 83% of which have been funded through Housing NSW. This is currently 12.5% of social and affordable housing in NSW and is expected to rise to 18-20% over the next two years. By that time, housing associations are likely to be managing 28-30,000 properties.

There are 31 housing associations in NSW; all of which are members of the Federation. In addition we have 69 other, associate and affiliate, members providing housing related services or who are housing associations in other jurisdictions.

The Federation provides a range of services to support the development and performance of housing associations and the wider social housing system in six core areas:

- **Representation and sector co-ordination** – this is our fundamental role as the peak industry body for housing associations in NSW. We provide a voice for members, and enable them to work together as a mutually supportive sector and to articulate and pursue their common aspirations.
- **Research and sector development** – this supports the members' directions and aspirations with effective research and policy development on key issues affecting the development of the sector
- **Relationships and alliances** – this ensures that associations are promoted and well-known to all other stakeholders who might help our development, and to allow associations to play their part in the wider community sector
- **Training** – this is our most prominent direct service to members and others in the social housing sector. We are a Registered Training Organisation. Through our Centre for Training in Social Housing, our accredited vocational training and other short courses support and build the capacity of organisations and the careers of workers in the sector. In addition we deliver the training for Department of Housing trainees, in partnership with Swinburne University. We also provide social housing training in the ACT and housing management training for SAAP workers in NSW and recently in Tasmania. We broker access to high level courses for senior managers and association directors in partnership with bodies such as the UTS Graduate School of Management and the Australian Institute of Company Directors.
- **Supporting organisations** – the Federation directly supports individual members, their boards and management, in their work as housing providers. This ranges from free advice provided

through our Housing Hotline, to consultancies on strategic planning, organisational reviews, tenant participation, through to intensive organisational change with organisations experiencing management difficulties.

- **Good practice resources** – through our Good Practice Unit, we also support our members and other providers by developing and continually updating resources on good practice social housing management. It includes the series of Housing Hints (produced in partnership with the Aboriginal Housing Office), Across the Board bulletins for directors of housing associations, comprehensive Good Practice Guides, and a good practice data base.

Particularly through our Centre for Training in Social Housing and Good Practice Unit, the Federation has become recognised as one of the leading experts in community housing management in country.

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2. The submission and its context

This submission will focus on two sections of the consultation document – chapter 7, Not-for-profit organisations, and Chapter 10, Tax and transfer impacts on housing. In particular, it will focus on the tax situation and proposals for not-for-profit affordable housing providers. Other questions raised in the above chapters of the consultation document will be addressed more briefly.

In 2001 the Federation made a submission to the Inquiry into the Definition of Charities and Related Organisations which made recommendations relating to the definition and scope of tax exemptions relating not-for-profit affordable housing providers. Our position in this submission remains consistent with that submission. In October 2008 we also made a submission and presented evidence to the Senate Standing Committee on Community Affairs Inquiry Into the National Rental Affordability Scheme Bill which dealt with the tax issues related to the operation of that scheme. Those tax issues are particularly relevant to this submission.

The wider context of this submission is the increased public policy importance of measures to provide and sustain the supply of affordable housing in Australia. The February 2009 report of the National Housing Supply Council, *State of Supply Report 2008*¹, identifies an undersupply of rental housing affordable and available to households in the lowest and second lowest income quintiles of between 200,000 and 250,000 units. It's conservative estimate of the gap between total demand and total supply, which reflects the gap for the most vulnerable households and the undersupply in the rental market, is 85,000 units growing to 203,000 units by 2013. It is worth noting that the current problem has been exacerbated by the steady loss of public housing supply over the past decade or more.

Many households also experience discrimination in seeking to access affordable housing or are forced to live in areas that impose high social costs (such as high travel costs, missed employment, training or educational opportunities).

The lack of affordable housing is a central policy issue affecting household consumption, access to the required workforce, the external costs and service needs associated with poverty, the spatial, social and generational distribution of wealth, and social inclusion generally. Under some circumstances, it can be a key factor in major economic effects.

The above estimates suggest a need for in the order of \$50 billion of investment in low cost rental housing over the next few years. The Commonwealth Government has responded to part of this with a number of measures such as the National Rental Affordability Scheme (NRAS) and the Social

¹ Australian Government, *National Housing Supply Council, State of Supply Report 2008*, Feb 2009. Table 5.1, p98

Housing component of the stimulus package. The success of these will depend on appropriate tax treatment.

It has also signalled a major policy shift in the supply of low cost rental housing to create a non-for-profit industry sector with a primary role in the development and management of low cost (affordable) housing. This policy shift was signalled by the Minister for Housing in a recent speech to the Sydney Institute². The change would mean a major shift from public housing management of affordable housing for the highest needs households to not-for-profit management. It would also mean a major role for the not-for-profit sector in the development and management of low cost housing products (mainly rental housing) across the housing market. In effect, this is an industry development policy as a key part of the response to housing affordability problems.

This submission is made with the above policy context in view.

The submission specifically addresses an aspect of Consultation Question 7.1.

² Plibersek, T. 'Room for more: Boosting providers of social housing', Sydney Institute speech, 19 March, 2009

3. The tax issues for NGOs providing 'affordable housing' and utilising NRAS

Overview

It is essential for the viability of not-for-profit housing providers (community housing providers) that they have access to the tax concessions related to being classified as a PBI or a Deductible Gift Recipient charity. This is because the income streams from low cost housing are insufficient and the cost of managing such tenancies responsively is higher.

It is also very important to the effectiveness of the development or acquisition undertaken with subsidies provided by NRAS, that these tax concessions apply – particularly exemption from GST, income tax exemption and some concessions from, for example, local government that are often linked to charitable status. In higher costs areas, where the need for affordable housing is greatest, it is usually fair to say that such concessions can be essential for projects to be viable.

Most community housing providers house tenants whose incomes have increased due to improved economic participation (usually as a result of stable housing). Increasingly community housing providers aim to house a range of households from those on very low incomes with complex needs to moderate income households in need of housing a lower than market cost to avoid housing stress. The involvement of specialist not-for-profit housing providers in this range of housing is also a key part of Commonwealth and State government policy to the supply of and access to affordable housing.

Unlike for-profits, not-for-profit housing providers redirect savings from tax concessions into responses for lower income households. For example, the lower costs may allow longer retention of NRAS funded properties in the affordable housing market or provide deeper subsidies to lower income households.

However, the current position of the ATO is that organisations providing affordable housing for any household not in receipt of the lowest possible incomes are not eligible for charitable tax status. Broadly, the position is that such organisations would not meet the “relief of poverty” head of charity under which most are registered as a PBI. They would therefore no longer be registered as a PBI.

The consequence of this is that:

- It would be unlikely that sufficient affordable housing would be provided in higher costs areas;
- Not-for-profit community housing providers would be excluded from affordable housing provision or management of housing for lower and moderate income households unless they

established separate entities to operate their ‘affordable housing’ business, in order to protect their existing ‘social housing’ business³. Indeed, it is not clear that establishing separate entities would be sufficient, if any aspects of the funding or operations of the affordable housing entity were supported by the (tax exempt) activities of the parent company;

- Moreover, the interpretation of the relief of poverty would preclude good practice in social housing delivery which is to provide housing security as tenants and their families improve their circumstances and participation in employment, education and social participation.

The Commonwealth Government has legislated to ensure that existing charities will have their registration protected if they provide affordable housing funded under the NRAS during its implementation phase. However, there is no such protection for the subsequent expansion phase, there is no such protection for organisations which have been providing ‘affordable housing’ that has not been funded by NRAS, and there is no such protection for new entities seeking to register as a charity in order to provide affordable housing.

The current approach to charitable tax status of not-for-profit housing providers threatens:

- the appropriate delivery of housing services to households in housing needs,
- the viability and future development of the industry, and
- an increased supply of affordable housing in the locations in which it is most needed.

The contribution of the tax system to facilitating both investment and the kind of service provision that will be responsive at the lower end of the housing market, should be significant concern of the current review.

Specific issues

Fringe Benefit tax Exemptions for PBIs

Fringe benefit tax (FBT) concessions are perhaps the most crucial for many NFP housing providers because it is the only way to provide salaries that can attract and retain the required workforce. This is now becoming even more crucial as the sector is growing rapidly and is facing key workforce demands.

The NSW Federation of Housing Association is currently developing a workforce strategy which projects a growth in the workforce in NSW of 70% in the next three years, and between 150% and

³ The terms ‘social housing’ and ‘affordable housing’ have been used as a shorthand for affordable housing for very low income households and affordable housing for low and moderate income households respectively.

350% in the next eight years⁴. Moreover, as providers grow from an average of 10 EFT staff today to an average of between 25 and 35 and manage very large portfolios, new positions such as middle management, chief financial officers, project managers, and a range of specialists will be required.

Some of these positions will be sourced from the commercial world, others from the real estate industry and a substantial proportion from the public housing sector. Currently, however, a typical housing officer in the not-for-profit sector is paid between \$40,280 and \$46,323 while their equivalent positions in the public housing sector are paid between \$47,127 and \$54,520. This gap of \$7,000 - \$8,000 is partly compensated for by FBT exemption from salary sacrifice which provides employees with a higher after tax income.

Using the current ATO example for a gross salary of \$65,000, the FBT exemption is worth \$4,475 net benefit to the employee or \$9,200 gross. Using this example, an average community housing provider in NSW would have to pay \$92,000 per annum more to maintain current staff benefits without the exemption. Within 3 years this will rise to \$156,000 and over eight years to between \$228,000 and \$327,000.⁵ For the largest NFP housing provider in NSW today, the additional cost would be \$350,000 increasing to \$1.1 million per annum in eight years time.⁶

GST on the construction and maintenance of low cost housing

The exemption from GST for inputs to housing provided at less than 75% of market price has two very major effects for NFP providers.

- The first is to the operating cost of a housing business. One of the most critical aspects of a sustainable housing business is the appropriate maintenance of the asset. Failure to implement a proactive maintenance plan results in sub-standard housing for tenants and either compounding asset liabilities or, ultimately, a reduce life for the dwelling. Over recent years State Housing Authorities have experienced the impact of underinvestment in maintenance and this has been a significant contribution to the serious decline in public housing stock in Australia.

The exemption from GST is worth at least \$71,500 per annum to an average NSW housing association managing 580 properties⁷. Again, this is projected to rise to \$180,000 in three years and between \$300,000 and \$480,000 in eight years.

⁴ Based on a moderate and a high growth scenario

⁵ This example is illustrative and the ATO example is based on a higher salary than is paid to most housing managers. However, it may be closer to the average of all salaries in the organization.

⁶ Projections are draft from the *Draft NSW Community Housing Workforce Strategy*, (NSWFHA: 2009)

⁷ Based on 55% of the properties managed. Currently around 45% of properties managed are headleased from private owners who have the majority of the maintenance liability.

- The second is the savings on the cost of construction. It is crucial to being able to provide low cost housing – particularly housing provided at 25% less than market, which is the ceiling for most community housing providers – that the cost of construction is reduced. Particularly in areas with higher land costs, such savings may be essential to project viability.

PBI status linked to State or local government concessions

A key saving for the acquisition of affordable housing is the State Government exemptions from sales tax. While arrangements vary between jurisdictions, this exemption is based on PBI status.

Incidental activities

Many of the developers or other entities who have begun to invest in affordable housing utilising the NRAS subsidies have no capacity to manage rental housing. In particular, they have no expertise in managing the risks (perceived or otherwise) associated with housing lower income households. As a result they have begun to enter arrangements with community housing providers to undertake the management of these properties in return for a management fee.

This arrangement has two benefits. First, it is particularly important to the successful expansion of affordable rental housing using NRAS, since the sustainability and the acceptability of such projects to investors or financiers depends on the special management expertise of community housing providers. Second, it provides another source of income for community housing providers to cross-subsidise their services for low income and higher need clients and to support the viability of the business.

On the face of it such activity should meet the test of being incidental to the charitable activities of the community housing provider. This should be even clearer following the decision of the High Court on Word Investments Ltd (HCA55).

However, the ATO has indicated that a narrow interpretation of ‘incidental’ is possible. That is that an incidental activity is one that is undertaken for the sole purpose of providing income for the organisation’s charitable purpose; and the test of the “sole purpose” is that the income is that fee for the service is a full market fee. In some cases, however, the fee may reflect the fact that the affordable housing is provided at below market rates, thus failing this narrow interpretation.

While it is not clear whether management arrangements or other forms of involvement with investors in affordable housing would or would not fail the incidental test, the very fact that there is

such uncertainty acts as a disincentive to engaging in an activity which may be very important to building more sustainable organisations and to expanding affordable housing provision.

Using the ‘relief of poverty’ head of charity as it is currently interpreted by the ATO defines the charitable activity narrowly in terms of a target group rather than broader social purpose. In the case of housing provision, this can only result in perverse social outcomes such as the creation of housing stress, the dislocation of supports and creation of poverty traps.

Recommended changes

The provision and appropriate management of a sufficient supply of affordable rental housing in Australian housing markets should be a major policy objective for the Australian taxation system.

This will only be possible if there are incentives to invest in rental housing and to direct this investment to the bottom end of the market. To a significant extent, negative gearing has acted as an incentive for investment in rental housing, but it has utterly failed to bring investment into the bottom end of the market. Moreover, all investment has been retail investment (and the little that exists at the bottom end has often been characterized as ‘accidental’). The Commonwealth government introduced the NRAS to both attract significantly more investment at the bottom end and to attract institutional investment. Ultimately, the objective is to create a new asset class and investment market.

A key part of this is to create a new industry of not-for-profit developers and affordable housing managers who will deliver such housing across a spectrum of housing needs in an integrated way, and who will provide both the appropriate management to give confidence to the market and sustainable housing for consumers. Such a sector will also provide a better basis for building the robust industry information necessary to establish a new asset class and appropriate risk profiles. Without this, the cost of funds is likely to be unnecessarily high.

Such a sector and type of business is not sustainable without access to the raft of concessions associated with charitable status. Without them, based on the examples above, the operating cost of an average community housing provider in NSW would be at least \$163,500 per annum higher. As the sector grows this will rise to at least \$336,000 per annum in three years and over \$800,000 in eight years.

The current approach to the charitable status of not-for-profit organisations providing affordable housing must be changed to support such a sector. There are broadly two options:

- A range of concessions could be specifically made available to any provider of affordable housing, both not-for-profit and for-profit. This would meet the test of competitive neutrality and would side step the question of whether affordable housing meets the test of charitable purpose. However, it would restrict access to the other benefits linked to PBI status such as access to sales tax exemptions or other exemptions provided by State and local governments on the basis of PBI status and access to gift deductibility.
- The other alternative is to include a new head of charity or an extension of the charitable purposes under the “other purposes beneficial to the community” head, to explicitly identify the provision of affordable housing as a charitable purpose as was done for not-for-profit childcare services. This would remove all uncertainty related to the relief of poverty head and any uncertainty about whether the management of affordable housing on behalf of investors is incidental.

Recommendation: **That a new head of charity or an extension of the charitable purposes under the “other purposes beneficial to the community” head, to explicitly identify the provision of affordable housing as a charitable purpose**