

Build-to-Rent: an emerging asset class in New Zealand

Parliament enacted the Taxation (Annual Rates for 2022-23, Platform Economy, and Remedial Matters) Act 2023 (Tax Amendment Act) on 31 March 2023, establishing build-to-rent (BTR) as a specific and recognised asset class in the New Zealand real estate market.

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What is BTR?

BTR assets are typically large residential developments that comprise a number of dwellings to be held long-term for rental investment rather than for sale on completion. The developments are professionally managed and usually owned by a single institutional investor. BTR assets offer tenants the security of long-term leases (generally with

tenant favourable break rights) and often include additional shared amenities (eg, co-working facilities, gymnasiums, event venues).

The BTR sector is significant in many overseas jurisdictions and a number of developers and investors have increasingly been looking to invest in this space in New Zealand. There have however been a

number of domestic policy settings, particularly from a tax perspective, which affect the feasibility of BTR developments. The Tax Amendment Act addresses one of these key policy issues but, as outlined below, a number of further important issues remain in the BTR context.

Having regard to the current housing crisis across the country, both with respect to supply and affordability, research undertaken by Property Council New Zealand indicates that New Zealand could deliver over 25,000 BTR homes in the next decade if the right policy settings are adopted.

Interest deductibility

The Tax Amendment Act provides that “build-to-rent land” is exempted from the interest limitation rules for residential properties under the Income Tax Act 2007 (**ITA**) in perpetuity. BTR has been added to the list of “exempted residential land” in Schedule 15 of the ITA. This exemption allows investors to deduct (from their taxable income) interest on loans relating to BTR assets for as long as that interest has a sufficient nexus with the income derived from those assets. The exemption is retrospective from the date the interest limitation rules took effect on 1 October 2021.

To qualify as a BTR development under the ITA the development must:

- comprise 20 or more dwellings to be used for residential tenancies under the Residential Tenancies Act 1986 (**RTA**) and:
 - in the case of dwellings

completed before 1 July 2023, the landlord must offer any current tenants **before 1 July 2023** a fixed-term tenancy of not less than 10 years, and must always offer future tenants such a tenancy;

- in the case of dwellings completed after 1 July 2023, the landlord **must always** offer prospective tenants a fixed-term tenancy of not less than 10 years;
 - the tenancy agreement must expressly refer to the ability of the tenant to personalise the dwelling with the consent of the landlord in accordance with the RTA, and include examples of possible personalisations and the landlord’s position on the keeping of pets;
 - the tenancy agreement must provide that the tenant may terminate on 56 days’ notice; and
- not include land that at any time after first meeting the

above requirements, fails to meet the above requirements.

Te Tūāpapa Kura Kāinga - Ministry of Housing and Urban Development (MHUD) will be responsible for maintaining a register of “build-to-rent-land”. Only land that is recorded on this register will be entitled to the exemption from the interest limitation rules. Taxpayers must apply to MHUD to have their land registered. The owners of existing BTR assets have until **1 July 2023** to apply to MHUD to qualify for the exemption.

Remaining issues

While the position regarding interest deductibility is a positive step for BTR developments, the Tax Amendment Act does not address all of the current legal and economic barriers to BTR in New Zealand. The following legislative issues remain unresolved:

- Overseas persons will require the consent of the Overseas Investment Office (**OIO**) if they:
 - acquire interests in sensitive



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- land; or
- enter into transactions, or establish businesses, where the expenditure exceeds NZ\$100m (although higher monetary thresholds may apply for certain investors).
- All residential land (regardless of size) is deemed to be sensitive land pursuant to the Overseas Investment Act 2005 (**OIA**). As BTR developments involve residential land and may involve investment exceeding NZ\$100m, BTR operators who are overseas persons will require the OIO's consent. While the initial investment and development may benefit from being processed under the increased housing test, the disposal of completed developments will

- be more difficult. This creates liquidity concerns for BTR developers and investors as the potential buyer pool of BTR assets in the secondary market is restricted and the transaction costs of transacting BTR assets are higher than they otherwise would be.
- Residential building owners are effectively not entitled to claim depreciation deductions from their taxable income (as opposed to the owners of non-residential buildings who are able to claim depreciation deductions of either 1.5% or 2% per annum depending on the tax depreciation method adopted). Consequently, the owner of a BTR development will not enjoy the depreciation

- deductions that the owner of a "non-residential building" is entitled to. Student accommodation and retirement villages are generally treated as non-residential buildings for depreciation purposes.
- Residential accommodation is an exempt supply of services for the purposes of the Goods and Services Tax Act 1985. Consequently, residential landlords are generally unable to recover GST input credits for expenses incurred in respect of residential developments. The inability to recover GST during the development stage materially reduces the economic feasibility of a BTR development and creates a disadvantage to a situation

where an otherwise identical asset is developed for the purposes of selling the individual dwellings.

National's proposal

Chris Bishop (the National Party's spokesperson for Housing) introduced the "Boost Build to Rent Housing Bill" in March 2023. National's proposal seeks to address the OIO and the depreciation issues by amending:

- the OIA to align the treatment of "build-to-rent developments" with student accommodation and retirement villages by including "build-to-rent developments" within the definition of "long-term accommodation facility"

(streamlining the consent process under the OIA if certain other criteria are satisfied); and

- the ITA to permit "build-to-rent developments" to claim depreciation deductions for income tax purposes like non-residential buildings.

Neither the Tax Amendment Act nor National's proposal seek to address GST recoverability (although it is expected that the GST issue will be considered from a tax policy perspective in the near future, following the general election in October 2023).

Next steps

As noted above, while the Tax Amendment Act brings welcome change for the economic viability

of BTR developments, there remain certain unresolved issues that may well be discussed at length during the lead up to the general election.

If you would like to discuss any BTR related matters, please get in touch with one of the experts below or your usual Russell McVeagh contact.

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