SAFE AS HOUSES

Position Paper on Australian Residential Rental Policies

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Being a landlord is becoming increasingly less attractive due to the introduction of government legislation. With less landlords, there are fewer rental properties, increasing competition between tenants, resulting in increased rent and in some case homelessness.

This paper provides solutions to overcome this problem.

Background

Housing is particularly important to Australians, evident in Australia having one of the highest rates of home ownership in the world. The housing industry, along with the mining industry, underpinned Australia's world record run of economic growth from 1991 to 2020.

Housing is also a political issue in Australia, with a falling rate of home ownership perceived to be a failure in economic policy. Successive Federal Governments from both sides of politics have tried to address this by introducing assistance packages for first-home buyers as well as making it more difficult for property investors and international buyers to compete against local home buyers.

In parallel to this, various state governments have also attempted to placate the growing number of residential tenants, who were unable to purchase a home of their own, with legislative changes that increase the rights of tenants. It would seem little regard was given to the impact of these changes on Australia's 2.1 million individual landlords.

This lack of regard for landlords was clearly evident in the legislative response to COVID-19. Recognising the financial damage these policies were having on individuals and businesses, the State and Federal Governments moved to ensure the affected public had a roof over their heads, not by paying their bills as they did with childcare, but by legislating that the supplier (landlords) continue to provide the service without payment.

The majority of Australia's landlords are mum and dad investors. Property investment is often used by tradespeople to fund their own retirement, particularly as they know they won't still be on the tools in their late 60s when the official retirement age kicks in. Governments need to rethink the current legislation as it is having unintended negative consequences.

This paper outlines a more pragmatic approach to the crucial issue of providing housing for all Australians.

Key Factors

Any long-term solution to a problem needs to satisfy the needs of all the stakeholders. With housing the solution needs to address:

1. Availability
2. Affordability
3. Risk of Ownership

Availability

There are currently enough dwellings in Australia to house all Australians. However, the location of the available dwellings and the location of those seeking a dwelling are not always aligned. This is evident in the current occupancy rates of rental dwellings across Australia with a net migration of people out of central Melbourne and Sydney, increasing vacancy rates in these two places, while vacancy rates are at record lows outside these two cities.

While there is some speculation that this will be a long-term post COVID-19 trend. What it does highlight is that housing has limited flexibility. Dwellings take time to build, and once built they stay put. This lack of flexibility also impacts on individuals – 15% of landlords are also tenants, many of whom have needed to relocate for work and are hoping to return to their rental property at some point in the future. Because of this inherent inflexibility, property values and rental values will inevitably rise and fall as changes in population, income and lifestyle impact on supply and demand.

Therefore, dwelling creation is best managed by a free market.

The allocation of available rental properties will be addressed later in this paper.

Affordability

The long-term trend of rising house prices across Australia is well documented. The Australian Taxation Office and the Australian Bureau of Statistics combined to produce a paper on what has been driving this trend throughout this century. They concluded that there were two key factors:

1. During the first decade the major factor was declining interest rates
2. During the second decade the major factor was population growth

Despite the political rhetoric, property investment by individual landlords was not considered to be a significant factor in housing prices. In fact, negative gearing (through which the landlord provides the rental property at a loss), has helped keep rental prices down.

A separate Federal Government report into superannuation has also identified that superannuation is one of the factors that is preventing younger working Australians from buying their first home. This is because superannuation is taking money they could be using to save for a deposit or buy a house and setting it aside for other investments. This is particularly relevant as home ownership was identified as one of the best ways to prepare for retirement, which is the intended purpose of superannuation.

Rental accommodation is a subset of all housing that follows the same long-term trends in regard to what is considered desirable. The long-term trend toward larger houses, sometimes dubbed McMansions, has resulted in houses today being three times larger than they were 50 years ago. At the same time modern block sizes are less than half what they used to be. Changes in town planning has also encouraged higher density housing, particularly in the capital cities.

COVID-19 restrictions, particularly in Melbourne, severely tested the suitability of high-density housing when access to public and shared amenities was restricted. Many tenants have exercised the flexibility provisions in their leasing arrangements to relocate to houses and locations better suited to lockdown scenarios. Whether this trend is reversed as COVID-19 restrictions ease remains to be seen. Historically, there have been numerous shifts in rental demand that have temporarily disrupted local markets. The Perth market, and regions close to major mining activities have all experienced significant peaks and troughs in line with mining booms and busts. In the longer-term the market will inevitably find its own equilibrium.

Unfortunately, even in a stable market there are some Australians who find it difficult to buy or rent a home. Many of these are on various combinations of welfare and unstable income (gig economy). While affordability is a factor for them, a bigger factor is that they often fail to meet the financial criteria for a successful loan and/or rental application.

Facilitating housing affordability is addressed later in this paper.

Risk of Ownership

Property investment is a long-term proposition with ongoing costs. Therefore, any increase in uncertainty has a significant negative impact on the appeal of the investment. Traditionally there have been three major risks of property ownership:

- Property values
- Rental market
- Interest rates

Now there is a fourth major risk – government legislation. Even without COVID-19, the changes in residential rental legislation, particularly in the eastern states, has substantially increased the risks associated with long term residential rental ownership. The trend toward giving the tenant the rights of ownership without the responsibility of ownership was already in place pre-COVID-19. What COVID-19 legislation has done is highlight the substantial risk the new legislation represents to landlords when tenants go rogue.

This increased risk is also evident in landlord insurance policies which have responded with increased premiums, higher excesses and longer lists of exclusions.

There has been an assumption among policy makers that there will always be properties for rent, an assumption exposed by COVID-19 policies toward landlords, but property investors buy and sell in the same market as everybody else. When landlords sell, the new owner may not be a property investor. Subsequently, the size of the rental market can change very quickly. With several state governments led by Victoria and Queensland, continually extending the rights of tenants, landlords are reassessing the risk of ownership, (refer to appendix for more detail). This trend is resulting in an increasing number of landlords getting out of the long-term rental market by either selling or repositioning their property for holiday rentals.

Minimising risk of ownership is addressed later in this paper.

The Solution

There is a twin policy solution to solving housing availability in Australia. One addresses rental affordability and availability, the other will make home ownership more accessible.

1. Secure Housing

Defence housing recognised many years ago that defence families wanted to live in the same houses and neighbourhoods as everyone else. Similarly, tenants want to live in the same houses and neighbourhoods as everyone else. The Defence Department[1] solution was to act as the intermediary between individual landlords and the highly mobile defence personnel ensuring both parties got what they needed. This has been a successful long-term strategy.

Similarly, in childcare, the government is paying childcare providers subsidies[2] on behalf of families, calculated relative to family income to ensure it is affordable to all. The proposed solution draws on these two successful government programs to create a housing strategy that addresses:

- Availability of dwellings (Open markets)
- Affordability of rental (Childcare model)
- Low risk of ownership (Defence Force model)

Under the Secure Housing Scheme, the government will underwrite the tenants in two ways:

a. **High-needs tenants** – (An example of high-needs tenants would be homeless women over 50, who are the largest cohort of homeless). These will be fully underwritten by the government in the same way that the defence force underwrites defence tenants, paying the landlord directly and covering the cost of repairs and maintenance during the tenancy so that the property is returned in the same state it was leased. Note: the government may wish to impose its limits on rent values, and conditions on tenant behaviour and frequency of property inspections as part of this program. In some circumstances it may also seek to receive a contribution from the tenant toward the rent.
b. **Other tenants** – These will be guaranteed by the government as the creditor of last resort, such that the government will pay for any outstanding rent or damage awarded to the landlord by a tribunal or court. The government can then use its own powers to recover these costs from the tenant.

There are three other elements of the Secure Housing Scheme:

- landlords will be required to give priority to high-needs tenant applications.
- Landlords will be required to be fair and reasonable (as per the Australian Landlords Association Code of Conduct[3]).
- Review of all tenancy legislation (State and Federal) to ensure it is fair and equitable and does not discriminate against landlords based on their own residency.

[1] https://www.dha.gov.au/investing
[2] https://www.servicesaustralia.gov.au/individuals/services/centrelink/child-care-subsidy/how-much-you-can-get
[3] https://www.australianlandlords.com.au/

2. Super Offset Account

Residential Property Investors have been unfairly blamed in public discourse for Australia's next generation of home buyers being unable to afford to buy their own homes. The are two fundamental factors in the increasing gap between housing affordability and house prices, neither of which is related to property investors. The first is that property prices have increased at a higher rate that CPI, Reserve Bank research[4] has found that this is due to lower interest rates (2001 to 2009) and growing population, (2010 to 2020). The second factor is lower wage growth and reduced savings, government research[5] has also found that compulsory super is a major contributor.

With superannuation intended to help fund retirement, and home ownership revealed as a financial cornerstone of retirement, it seems obvious that Australians should be able to access their superannuation to help finance their home.

To ensure that this is not abused, and that the superannuation funds remain in the system, it is proposed that a new type of superannuation account be made available to people with home loans – the Super Offset Account. This would function in the same way as other bank offset accounts, effectively reducing the size of the mortgage on which interest needs to be paid by the balance held in the Super Offset Account. As with other superannuation accounts, the money can be transferred freely between this account and other superannuation accounts at any time.

[4] https://www.rba.gov.au/publications/rdp/2019/pdf/rdp2019-01.pdf
[5] https://treasury.gov.au/publication/super-system-review-final-report

Appendix - Risk of Ownership

There are two major categories of risk involved in residential real estate investment.

- Market risks, which apply the general principles of investment to property.
- Operational risks, which look at the risks associated with being a rental provider.

Market Risks

There are several inherit market risks involved in investing in residential property.

Risk	Commentary	Risk Mitigation
Fluctuations in Property Prices	As with other investments, property owners are looking for an increase in the value of their investment over time. Therefore, a stagnant or declining market is a major risk to property owners. As outlined in this paper, RBA research suggests that the primary causes of increased property prices have been lower interest rates and increased population.	These risks are long established and well known to residential property owners and have traditionally been mitigated by: • Monitoring interest rates • Monitoring population trends • Monitoring 'property trends' for what are considered desirable features.
Fluctuations in Interest rates	Loan repayment has been identified by the ATO as the most significant cost of ownership. Therefore, significant increases in interest rates represents considerable risk to property owners.	The risk implications of interest rate fluctuations are well known to property owners and are generally mitigated by: • Monitoring interest rates • Maintaining a financial buffer to protect against unexpected increases • Electing to have fixed interest loans
Fluctuations in Rental demand	Fluctuations in rental demand pre-COVID have generally been strongly correlated with local economic activity, which itself is usually heavily correlated with changes in local population.	It is generally accepted that property investors need to understand the underlying economic drivers of their local economy when buying a property and monitoring these closely through the duration of their ownership. These risks can be mitigated by: • Monitoring the local market • Adjusting rent to meet local expectations • Buying and selling ahead of the curve.

Operational Risks

There are several operational risks associated with being a rental provider:

Risk	Commentary	Risk Mitigation
Repairs and Maintenance (including body corporate)	While these are the same sort of expenses that homeowners face, they are generally more expensive for landlords, (e.g. paying an electrician to change a lightbulb).	• Due diligence on purchasing
Compliance costs	Increased complexity is driving up legal and accounting fees. While at state level increased requirements for independent review of e.g. increased number of smoke detectors, periodical gas, electrical checks, etc. are also increasing compliance costs.	• No possible mitigation, other than increasing rent to cover increased costs.
Rates and Taxes	A series of substantial increases in land taxes in some states (particularly Victoria) are increasing costs.	• No possible mitigation other than increasing rent to cover increased costs.
Damage to Property	Changes in legislation in relation to property access (for inspections) and inability to evict are substantially increasing risks.	• Tenant selection* • Landlords' insurance • Rental bond**
Tenant Debt	Even when legally acknowledged money owed by tenants is often difficult to recover. Particularly after a tenant vacates a property without a clear new address. Changes in legislation are increasing the level of debt exposure that landlords are facing (particularly during COVID-19).	• Minimise debt exposure by acting early • Landlord insurance • Appoint debt collector
Tenancy Dispute	There are two legislative changes that have dramatically increased the risk of ownership: • At a state level, legislative changes (in Victorian and Queensland in particular, with potential for NSW and WA to follow), that increase the rights of tenants, and the period of unpaid occupancy prior to eviction have substantially increased the potential cost of a dispute. • Nationally, a 2018 High Court ruling[6] has made it impossible	• Change type of rental arrangement to operate outside of legislation. For example, using short-stay platforms to manage bookings and payments, rather than using long term rental contracts. • Exit the interstate rental market. (Note: interstate property was previously a recommended strategy of risk mitigation by diversifying investment). • Increase rental bond**

[6] http://eresources.hcourt.gov.au/showCase/2018/HCA/15

	for interstate landlords to use the normal dispute channels (state Civil and Administrative Tribunals). South Australia has shown that this can be mitigated by State legislation[7].	• Tenant selection and property management • Exit the residential real estate market.

Notes:

* Tenant applications processes are an important element of risk reduction.

**Rental bonds previously provided coverage for unpaid rent and/or damage (insurance excess), however new legislation increasing potential period of unpaid rent leaves landlords heavily exposed.

[7] http://www.sacat.sa.gov.au/upload/Disputes%20where%20one%20party%20is%20interstate.pdf

Feedback

Feedback and comment on this position paper can be made to the Australian Landlords Association via the Contact Us Form.

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