SHELTER

NEW SOUTH WALES

Submission on the Residential Tenancy Law Reform Options Paper

Shelter Brief 26

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About Shelter NSW

Shelter NSW is a community-based, state-wide, peak body, which promotes the housing interests of low-income and disadvantaged people in New South Wales.

Shelter's mission is to work for a just and equitable housing system. We

- promote a coordinated response within the community sector to housing issues impacting on access to housing by low-income and disadvantaged people;
- work with and influence government and relevant community sector organizations to develop housing policies and programs that meet the needs of low-income and disadvantaged people and offer appropriate housing solutions;
- increase public awareness of housing issues and support for adequate and sustainable responses;
- research and develop responses to housing issues;
- provide quality information, assistance and support to the community sector, members and other stakeholders.

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1. Introduction

1.1 The Options Paper identifies "Tenure" as an area for "major strategic reform".[1] Under this heading, it proposes that legislation provides for long term leases as one method of satisfying the desire of tenants for security of tenure. Tenants organisations have long argued that, without security of tenure, tenants are unable to fully utilise those rights granted to them under residential tenancies legislation. Needless-to-say, security of tenure is one of the most contentious issues in the debates around residential tenancy law reform. This submission from Shelter NSW will focus on the issue of long term leases only, because Shelter NSW is looking at how secure, long-term, affordable housing can be provided in the private rental market. Shelter NSW will not seek to address the full range of issues canvassed in the Options Paper as this is a task more appropriately left to the Tenants' Union of NSW.

2. The context

2.1. The private rental market has been strong in Australia since the 1980s. Paris[2] explains the relative prosperity of Australia's private rental market in terms of the effect of the interaction of the expansion of home ownership and the advantageous tax treatment of rental property investment – the latter being largely the combination of negative gearing and a modest capital gains tax:

> "The distinctive combination of these two dimensions of Australian housing provision 'has transformed the private rental sector from an investment vehicle providing long term rental income yield to one which primarily provides short-term capital appreciation … only realisable through sale into a market where prices are primarily determined by demand from home-owners'".

This encourages relatively short term investments.

2.2. In the past decade there has been an unprecedented level of investment in private rental housing. Yates, Wulff and Reynolds[3] attribute the reason for this to taxation provisions that encourage negative gearing amongst investors facing high marginal tax rates and which, through the interaction of depreciation allowances and capital gains taxes, encourage investment in new rental dwellings.

2.3. However, the overall increase in the rental housing stock masks an important fact. The increase in private rental stock has been largely at the top end of the market. At the same time *there has been a loss of stock at the bottom end of the market.* Low income tenants, as well as facing a dwindling supply of stock, are also facing competition from better-off tenants for lower cost rental housing.[4]

2.4. Most commentators agree that investment in rental property is the domain of small, individual investors, who rarely own more than one or two dwellings.[5] This finding is supported by a study by Australian Bureau of Statistics in 1997, which found that most investors were small investors, with 76% owning or partly owning one property only.[6] On top of this, individuals who invest in low rent stock tend to have lower incomes than rental investors overall. As a consequence such landlords receive fewer tax advantages and potentially are the most likely to leave the market.[7]

2.5. Individual investors (together with temporary landlords) are the dominant types of landlords in the private rental market.[8] Such types of landlords reserve the right to obtain easy vacant possession in order to sell in the owner-occupation market with vacant possession so as to maximise capital gain. It is not in their interest to prejudice the ease of obtaining vacant possession by agreeing to long term leases.[9]

2.6. Neil Youren of the National Australia Bank has argued that an "investment grade product" attractive to institutional investors will lead to the provision of longer leases.[10] Yet, unlike many other comparable countries, Australia does not have a tradition of institutional investment in private rental dwellings. Berry, Whitehead, Williams and Yates[11] state:

> Prominent by their absence have been professional and institutional investors. … The absence of the institutions from the rental sector has been caused by a number of economic and institutional factors that cause expected returns on equity to fall well below that required to compensate for a range of risks, including vacancies, tenant behaviour, illiquidity, poor market information and weak property management. These barriers to investment apply particularly at the lower cost end of the rental market.

2.7. Indeed, financial institutions such as superannuation funds are looking for socially responsible investment opportunities but choose not to invest in affordable housing for the reasons stated above.[12] The financial pages of the daily newspapers often discuss new offerings by fund managers seeking to attract investment from superannuation funds in the retail, office and industrial property markets, but not rental housing. [13] It is therefore important to address supply-side strategies that can attract private investment to the provision of secure, long-term, affordable housing in the residential rental market.

3. Supply-side strategies

3.1. Berry, Whitehead, Williams and Yates[14] state that one of the persistent recommendations of policy reviews and enquiries over the last decade in Australia has been the need to encourage increased private investment into affordable housing at the lower end of the rental (and owner-occupied) market.

3.2. Yates, Wolff and Reynolds[15] suggest that the shortage of low rent stock in the private rental market might be addressed through policies that pursue either "replacement" or "market supplementation". "Replacement" occurs by creating a secondary rental market for low income tenants to ensure that the low income stock that does exist is allocated to those households most in need of it. The current head-leasing in social housing is an example of this, but it does address the need to increase the total stock. "Market supplementation" sees a role for supporting institutions prepared to fund potential housing providers. This may require new tax breaks, guarantees or other forms of direct subsidy[16] and also calls for re-examining tax incentives that currently underpin provision of rental housing by the private market, with tax reform directed towards investment in low cost housing targeting low income tenants.[17]

3.3. A study by Berry[18] outlines three models which he argues are likely to be attractive to institutional investors: a Commonwealth outlay subsidy to support the States and Territories borrowing to finance an increase in stock of social housing; launching an equity vehicle on the Australian Stock Exchange, dependent on a Commonwealth equity injection and state revenue subsidies to meet investor returns; a non-profit company financed by an initial non-refundable, dividend free equity injection by a State government, complemented by State borrowings and voluntary developer contributions. In each model, the government subsidies provided were significantly “leveraged” by private investment.

3.4. Berry, Whitehead, Williams and Yates[19] examine a number of models designed to attract investment at the bottom end of the market. All require some form of subsidy. One, which was developed by the Affordable Housing National Research Consortium,[20] is “The Consortium model” where government assistance is used to leverage institutional funds into investment in affordable housing. The preferred option requires state and territory governments to each sell long-term bonds at market prices to private investors. Berry and others argue that institutional investors such as superannuation funds appear to be very keen to purchase such bonds. Another model developed by Macquarie Bank would pool the savings of professional retail investors into a fund to be used to acquire housing for rental managed by community housing organisations. Investors would receive an overall return based on both the rental yield and the capital gain. Macquarie Bank also suggests a model that trades on the current nature of the private rental market as a “cottage industry”. This approach simply rests on governments providing specific incentives to small investors to leave more of their savings in affordable rental housing: incentives being a tax exemption on part of their rental income when they lease their dwellings to community housing organizations. State governments could also offer land tax and local rate exemptions. These savings and subsidies can then be passed on to the tenant as lower rents. Berry and others cite a model proposed by Gavin Wood to deliver greater incentives for small landlord investors to provide more low cost rental housing. This is through income tax and capital gains tax subsidies, thus increasing financial incentive for existing and prospective private landlords to remain in and expand the low rent segment of the market.

3.5. The Allen Consulting Group[21] argues that private sector finance will be an important element of any long term solution that addresses the shortage of affordable rental housing. They state “much of the nation’s housing affordability problem can be overcome if governments can stimulate institutional investment in affordable rental housing … [targeting] low and moderate income households.” They examine three policy options: bonds, partnerships and tax credits and demonstrate that the financial costs are modest while the economic and social benefits would be substantial.

4. Long-term leases

4.1. The importance of long term leases is highlighted by research published by the Australian Housing and Urban Research Institute. It shows that long term leases are important for the most marginalised groups in our community. A study of private tenants in inner city Brisbane and Ipswich[22] found that although nearly two thirds of those surveyed would prefer a short term lease that could be extended if required, rather than a long term lease, the security and stability of a longer lease was important to higher proportions of households comprising older people, those on the lowest incomes, those receiving income support assistance, single parent households and those with school aged children. Most of these are the households who are the most vulnerable in the private rental sector.

4.2. The Minister for Fair Trading's media release dated 7 July 2005 highlighted "proposals up for discussion included longer leases – greater than 5 or 10 years – such as those common in parts of Europe". This was reported in the *Sydney Morning Herald* (8 July 2005 p.9) as "Europe-style deals proposed to reflect contemporary life". In theory, under current legislation, there is nothing to stop tenants who wish to enter into long term leases negotiating with their landlord to do so. The Options Paper (p 7) argues that the reason for the predominance of short term leases is because "tenancy law does not provide sufficient flexibility to encourage long term leases". It gives the landlord's inability to pass on responsibility for repairs to the tenant and the need to lock all future rent rises into the lease as deterrents.[23]

4.3. Such arguments presented in the Options Paper are misconceived. A change to long term leases cannot be driven by legislation. It will only be driven by economic policies that put in place supply-side strategies that lead to a change in the structure of the private rental market, so that the types of landlords who predominate find it economically viable to provide long term leases. "European style" long term leases derive from a history where governments provided subsidies to landlords and, as a trade-off, landlords provided security of tenure which made the provision of long term leases possible. [24]

4.4. While we acknowledge that the New South Wales Minister for Fair Trading does not have the brief to look at supply side issues, it is a matter that governments must address if talk of long-term leases is to be more than rhetoric.

4.5. In the absence of supply-side strategies that encourage more institutional investors into the private rental market, there is little likelihood of long term leases becoming common place. The current proposal set out in Option 2.1 presents a very real danger: this being, that in the absence of supply-side strategies, a small number of existing landlords who are prepared to contemplate leases of more than 10 years will seek to evade their responsibilities by off-loading costs onto tenants. Recent studies undertaken by AHURI and others look at strategies required to increase the supply of affordable housing at the bottom end of the housing market. These have been referred to above. *None of the proposals suggest that landlords should transfer their costs to tenants*.

> *Recommendation: That the Government not legislate to allow partial or total exemptions from the provisions of the Residential Tenancies Act for all residential tenancy agreements including those over ten years.*

5. Tenancy rights and long term leases

5.1. Should long-term leases become a part of the residential rental market, a number of issues will need to be addressed. The Parks and Village Service has identified issues surrounding long-term leases in residential parks in its submission to the review of the Residential Parks Act 1998.[25] The issues for the residential rental market are similar. The two most important issues are registration of leases and assignment and sub-letting.

5.2 If a long-term lease is not registered under the requirements of Section 53 of the Real Property Act 1900 then it is not enforceable against a later person with a legal interest, such as a new owner. The tenant is therefore denied the security of tenure to which they would otherwise have been entitled. The Residential Tenancies Act 1987 should require that it be a standard term of a residential tenancy agreement, where the fixed term exceeds three years, that the lease be executed in a registrable form and duly registered in a timely fashion. Problems arise where the lease is for only a portion of a lot or does not accurately reflect an existing lot. The landlord should be liable for any costs eg Development Approval for subdivision and obtain any documents necessary to effect registration of the lease.

5.3. The tenant should not be precluded from assigning or sub-letting a long term lease. The circumstances of the tenant may change due to health, family reasons, work commitments, etc and they may no longer be able to remain in the tenancy. The existing provision under Section 33 of the Residential Tenancies Act 1987 allows a landlord to unreasonably withhold or refuse consent to an assignment or sub-letting by a tenant. This would require an amendment to legislation to state that a landlord could not unreasonably refuse consent. This is particularly the case given that a tenant who applies to the Consumer, Trader and Tenancy Tribunal under Section 69A of the Residential Tenancies Act 1987 might find that the Tribunal makes orders requiring him or her to compensate the landlord for loss of the tenancy. Also, it would be advisable to provide for a “Deed of Assignment” for long term leases that include an express indemnity by the new tenant of the original tenant for liability arising under the agreement, and an express waiver/release whereby the landlord releases the original tenant from future liability.

5.4. Section 45 (4) of the Residential Tenancies Act 1987 currently allows for the landlord to increase the rent during a fixed term, provided a term of the agreement specifies the amount of the rent increase, or a method for calculating the amount of the increase. If other methods of rent increases are to apply to long-term leases, it is important that they be subject to review by the Consumer, Trader and Tenancy Tribunal.

> *Recommendation: That, where the fixed term of a residential tenancy agreement exceeds three years, it be a standard term of the agreement that the agreement be executed in a registrable form and duly registered in a timely fashion; further, that the landlord be liable for any costs for subdivision and obtain any documents necessary to effect registration of the agreement.*

Endnotes

[1] The “Table of Contents” on page 2 of the Options Paper is divided into three main sections, one of which is called “Major Strategic Reforms”.
[2] Chris Paris, *Housing Australia*, MacMillan, Melbourne, 1993, p. 176.
[3] Judith Yates, Maryanne Wulff, Margaret Reynolds, *Changes in the supply of and need for low rent dwellings in the private rental market*, Australian Housing and Research Institute, Sydney Research Centre, June 2004, p. 5
[4] Ibid., p. i
[5] Chris Paris, p. 189.
[6] Australian Bureau of Statistics, Household Investors in Rental Dwellings, cat no. 8711.0, Canberra, June 1997, p. 5.
[7] Judith Yates, Maryanne Wulff, Margaret Reynolds, op. cit., p. 39.
[8] Robert Mowbray, *The Nature of Contemporary Landlordism in New South Wales: Implications for Tenants' Rights.* A thesis submitted in fulfillment of the requirements for the degree of Doctor of Philosophy, University of Sydney, March 1996, p. i.
[9] Ibid.
[10] Talk given at the National Affordable Housing Conference in Sydney in June 2005.
[11] Mike Berry, Christine Whitehead, Peter Williams and Judith Yates, *Financing Affordable Housing: A Critical Comparative Review of the United Kingdom and Australia*, Australian Housing and Urban Research Institute November 2004, p. 54.
[12] Mike Berry, “Expanding the supply of affordable housing in Australia”, *AHURI Research & Policy Bulletin*, Issue 13, September 2002, p.4; Mike Berry, Christine Whitehead, Peter Williams and Judith Yates, op. cit., p. 57.
[13] “AMP's new offering of a multi-vitamin fund”, *Sydney Morning Herald*, 10 August 2005, p. 25
[14] Mike Berry, Christine Whitehead, Peter Williams and Judith Yates, op. cit., p. 56.
[15] Yates, Wolff and Reynolds, op. cit., p. 40
[16] Ibid.
[17] Judith Yates, Maryann Wulff and Margaret Reynolds, “Supply and demand in the low rent private market”, *AHURI Research and Policy Bulletin*, Issue 50, February 2005, p. 2
[18] Mike Berry, op. cit., p. 3
[19] Mike Berry, Christine Whitehead, Peter Williams and Judith Yates, op. cit., pp. 56-60.
[20] The Affordable Housing National Research Consortium was an ad hoc group comprising the Housing Industry Association, Australian Council of Social Service, Real Estate Institute of Australia, Australian Council of Trade Unions, National Community Housing Forum, Urban Development Institute of Australia, Property Council of Australia, Royal Australian Institute of Architects, Master Builders Australia, and Royal Australian Planning Institute.
[21] The Allen Consulting Group, “Better housing futures: Stimulating private investment in affordable housing”, Report to the Affordable Housing Forum, 2004.
[22] John Minnery, Barbara Adkins, Peter Grimbeek, Jennifer Summerville, Elspeth Mead and Diane Guthrie, “Do private tenants want longer-term leases?”, *AHURI Research & Policy Bulletin*, Issue 22, June 2003, p.1
[23] However, a significant barrier to tenants is the current provision under Section 33 of the Residential Tenancies Act 1987. This allows a landlord to unreasonably refuse a tenant's request to sub-let or assign. This issue is discussed later in the submission.
[24] Kemedy cites the example of Sweden – See Jim Kemedy, *The Myth of Home Ownership: Private versus public choices in housing tenure*, Routledge & Kegan Paul, London, 1981, pp. 94-95.
[25] Park and Village Service, “Submissions in Response to the Review of the Residential Parks Act 1998 Discussion Paper”, August 2004, pp 69 to 74.