SHELTER NEW SOUTH WALES campaign

Somewhere to call home

Campaign brief 2

Increased private supply of private rental housing for low rental

What we want

Increased private supply of private rental housing for low rental.

The situation we face

Private providers of rental housing are an extremely important group of providers of low-rent housing in New South Wales. But the supply of low-rent private housing is insufficient for the number of lower-income people who live, or want to live, in that housing tenure type.

Authoritative studies have found there is a serious shortage of stock (dwellings) in the private rental sector available to lower-income earners. When demand generally for private dwellings to rent is high, lower vacancy rates means that competition for those dwellings that do become free for rent is greater. In this situation, rents might be set higher that they otherwise would. Also, middle-income renters might compete with lower-income renters for the lower-rent dwellings.

Any rent asked for a dwelling in the private rental market is a ‘market rent’. But the rent asked for, or set, by a landlord or their agent will vary by location, type of dwelling, number of bedrooms, and its condition, etc. Within the range set, it is those dwellings at the lower end of the range, the ‘low market-rent’ dwellings, which lower-income households are more likely to seek.

There was a shortage of some 134,000 low-rent dwellings affordable and available for low-income private renters to rent in 2001 (the most recent date for which we have data from academic research).

Across Australia as a whole, a shortage of lower-rent dwellings is more acute in metropolitan areas than in country areas, and in inner suburbs rather than outer suburbs of the larger cities.

A healthy rental market would have a vacancy rate (being the proportion of rental dwellings available for rent) of about 5%. The smaller the rate the ‘tighter’ the market, and the harder it is for prospective tenants to find housing, and the greater incentive there is for landlords to increase rents. Vacancy rates vary across the state. In Sydney, it was 2.9% in June 2008 (SQM Research estimate).

The profile of providers of private rental housing (landlords) in Australia is largely that of ‘mums and dads’. Three-quarters on investors in residential property only own one, or part of one, property. The cheaper (lower-rent) properties tend to be owned by people who are themselves low-moderate income earners. Some small businesspeople have a collection of dwellings they own but the return on their assets to these investors in the form of income is marginal.

For investors to get good returns on the dwellings they buy, they will want to rent the dwellings out on rent levels that make the dwellings unaffordable to low-income households. When there was significant investment in private rental housing, in the early 2000s, this was mostly at the upper segments of the market. The cost of housing in high-demand locations means that it is not possible for private investers to get a sufficient return from low-income tenants; indeed, any rental housing let at submarket rents would need a government subsidy for the provision to be sustainable.

The private rental housing market has some submarkets with dynamics that are distinct from 'mainstream' private rental housing. Two of these are caravan park accommodation and boarding and lodging houses. The number of large caravan parks (defined as having 40 or more powered sites and dwellings) in New South Wales has halved since 2000, when there were 164 (Andy Marks, *Residents at risk*, St Vincent de Paul Society, 2008). The number of boarding and lodging houses also seems to be in decline. Part of this submarket consists of boarding houses licensed by the Department of Ageing, Disability and Home Care because it accommodates people with a disability, and it is fairly stable in size. The other part ('unlicensed') has traditionally been a key source of affordable rental housing for very-low income and transient people, especially in inner suburbs of Sydney. This market has seen two trends, a decline in supply over the last few decades, as inner-city suburbs have 'gentrified', and – more recently – a small movement of low-moderate income earners into it.

Why are we concerned about this?

A loss of low-rent private rental housing reduces choice of types of affordable housing for low-income people. Many low-income earners choose to live in private rental: two-thirds of the people eligible for public housing do not apply; and if they did, Housing NSW would not be able to house them.

What is being done?

The Commonwealth government has a number of measures in its taxation system that encourage or assist investment in residential property (rental housing). Those tax concessions are:

- an ability to claim some costs in providing it against their income for income-tax assessment purposes;
- an ability to include some costs in the capital base of the property and claim depreciation against their income for income-tax assessment purposes;
- an ability to write off the value of the initial construction cost of a leased dwelling at the rate of 2.5% a year over 40 years; and
- an ability to claim a deduction for the full amount of rental expenses against their rental and other income (e.g. such as salary, wages or business income) the property is purchased with the assistance of borrowed funds and the net rental income, after deducting other expenses, is less than the interest on borrowings; in 2005-06, 66% of individual taxpayers with net rental income were thus 'negatively geared'. Financial analysts suggest this investment strategy is more suited to top income earners; however, most of the taxpayers negatively gearing investment dwellings are low-moderate income earners – 70% of individual taxpayers who reported a negative income from rental properties had overall taxable incomes of less than $63,001 (2005-06).

None of those measures targets rental housing for low-income renters. However, the Commonwealth introduced a new scheme in 2008, the National Rental Affordability Scheme (NRAS), which aims to increase the supply of affordable rental housing. The scheme comprises a Commonwealth subsidy to additional housing that would be rented for at least 10 years at a rent that is no more than 80% of the median market rent in the area where the house is built. To be eligible for a tenancy in these dwellings an applicant for a tenancy who is a single person would not have an annual income over $39,251 – so, the income eligibility is more liberal than current public, community and Aboriginal housing in New South Wales ($22,880 for a single person). The new stock would therefore be available to a broader range of people (while not precluding lower-income tenants), producing higher rent revenues and assisting sustainability (profitability) for providers.

The Commonwealth government's intention is to encourage the production of 50,000 additional dwellings by 2012. The dwellings would be owned by the bodies financing their development, e.g. privately-owned property developers, financial institutions, or nonprofit housing/welfare organizations, not by the government. The dwellings assisted with the subsidy would have to be used for the purpose of the scheme for the duration of the subsidy (i.e. 10 years). The idea of the subsidy is to partly fill the gap.

The scheme involves a Commonwealth subsidy of $6,000 a year for 10 years to each dwelling produced, and a state government matching subsidy of $2,000 a year for 10 years to each dwelling produced. The Commonwealth estimates its contribution will be some $622 million over four years. A number of commentators have questioned whether the amount of the combined subsidy over the 10-year period, which could be around $90,000 (depending on the start date and indexation of the subsidy), will be enough of an incentive to make the housing projects profitable to providers and attractive to investors. This is particularly the case in more overpriced housing markets such as in New South Wales.

The Commonwealth government guidelines for the scheme allow for the property and tenancy management of the new dwellings to be undertaken by – among others – private businesses (e.g. real estate agents). This means it has potential to directly contribute to a supply of private rental housing let at submarket rents (though not necessarily low-market rent, though this would be at the discretion of the tenancy manager). It could indirectly assist low-income earners access low-rent dwellings by relieving some of the pressure (competition) for the low-rent stock in the market.

The scheme might work differently in New South Wales, however. Housing NSW will give priority in assessing proposals for incentives under the scheme to proposals where the property and tenancy management of the new dwellings is done by registered community housing providers, with a preference for 'growth' community housing providers. This is so for both Housing NSW's 'NRAS B' subsidy of $2,000 per dwelling for 10 years (for which any type of housing developer or provider may apply), and for its 'NRAS A' subsidy of up to 40% of project costs for a housing development (for which only registered community housing providers may apply).

The NSW government does have a number of small programs that encourage supply (or discourage withdrawal of supply) of private rental housing. It gives an exemption from land tax for:

- land used and occupied primarily for low-rent accommodation in inner Sydney (within a 5 km radius from the Sydney GPO) – this is worth less than $1 million a year;
- boarding houses where at least 80% of the accommodation is let to long-term boarders at low rents; this is worth $6 million a year;
- residential parks and retirement villages primarily occupied by retired people – this is worth some $97 million (2008-09).

Also, Housing NSW gives small grants to owners of boarding houses where 80% of the accommodation is let to long-term boarders at low rents, to assist providers to undertake work to meet fire safety standards e.g. sprinkler systems. The grant is also available for new boarding houses and extensions to existing ones. Boarding houses that are licensed by the Department of Ageing, Disability and Home Care are eligible. The grant limit is usually $50,000 per boarding house. The Boarding House Financial Assistance Program has a state budget allocation of $200,000 in 2008-09.

What could be done?

The sustainability of private providers in these housing markets catering to very low-income renters, often 'at risk' circumstances, is something that government could ignore. Market forces will work something out, but massive loss of that supply would put additional pressure on crisis accommodation and social housing programs. So the public and consumer interest is likely to be best promoted by selective use of actions that slow down the loss of privately-supplied low-rent housing and, better, encourage some growth. That is what is already, currently happening. The tools being used are financial subsidies, either in the form of grants or tax concessions.

Looking at tax concessions, the Commonwealth government's National Rental Affordability Scheme involves a $6,000 (per dwelling for 10 years) tax credit to private bodies developing additional housing for rental at submarket rents.

The state government gives concessions on land tax. There are arguments that the more exemptions and concessions there are in a tax system, the more inefficient and complicated it becomes (Independent Pricing and Regulatory Tribunal, *Review of state taxation: draft report*, June 2008). So, we might consider whether this is a better course of action, compared with grants.

The current exemption from land tax for land used and occupied primarily for low-cost accommodation is confined to inner Sydney. Should it be expanded to the inner and middle ring suburbs, where land and housing property price are also high? Should any extension be confined to property owners owning three or more properties – to benefit the small businesses in this market rather than the 'mum and dad' investor-owners of only one residential investment property?

Before the last state election the Opposition announced it would give a concession on transfer duty of $4,000 to buyers of dwellings for investment purposes where those dwellings were valued up to $500,000 and were let out to residential tenants for at least a 5-year period. However, the proposal did not explicitly tie the concession to provision of the rental housing at low-market rents.

Looking at grants, the one state government subsidy scheme that is targeted to private providers of housing to low-income consumers is the Boarding House Financial Assistance Program. Should the budget allocation be increased from the annual $200,000? Should the scheme be expanded in its scope to cover building work to improve habitation standards, or to improve environmental sustainability?

The state government also has responsibility for regulation of the terms on which providers and consumers (tenants) trade in the private rental market. Given the large numbers of people in that market who do not want to or are unable to move into either home-ownership or social housing, some housing advocates have raised the introduction of long-term leases as an option for greater flexibility and choice for tenants (Judith Yates and Vivienne Milligan, 'Housing affordability: a 21st century problem', AHURI, 2007). The Office of Fair Trading has discussed the introduction of a regulatory arrangement to encourage leases of 10 years or more ('Residential tenancy law reform: options paper', 2005; 'Residential tenancy law reform: a new direction', 2007), but reported opposition from many landlord and real estate agents since they feared being stuck with unwanted tenancies and with rent levels that could fall behind market trends.

This matter is relevant to supply of additional rental housing if such an arrangement, with the security it implies in terms of rental income, made investment in residential property more attractive to long-term and institutional investors. Of course, such an arrangement alone, in isolation, is unlikely to be sufficient motivation for such investment. Because there was no consensus among key lobby groups on this matter following the 2005 options paper – given a range of tenants' rights and landlords' rights implications it raises – the Office's 2007 directions paper simply said the matter should be subject to 'further examination and consultation'. Should a system of long-term leases be introduced to encourage stability in tenancies and rents for landlords, and so make investment in this market more attractive?

Questions

1. How might the National Rental Affordability Scheme be improved to encourage private landlords to provide rental housing at submarket rents?
2. Should the current exemption from land tax for land used and occupied primarily for low-cost accommodation be expanded to Sydney's inner and middle ring suburbs, or other areas? Should any extension be confined to property owners owning three or more properties?
3. Should the budget allocation for the Boarding House Assistance program be increased? Should the scheme be expanded in its scope to cover building work to improve habitation standards, or to improve environmental sustainability?
4. Should a system of long-term leases be introduced to encourage stability in tenancies and rents for landlords?
5. What other ways could the state government assist private providers supply low-rent housing to low-income renters?