

What impact does regulation of residential tenancies have on investment in rental property?



Based on AHURI Final Report No. 391: Regulation of residential tenancies and impacts on investment

What this research is about

This research reviews the evidence-base about factors impacting and shaping rental investment; reviews the state of residential tenancies laws across Australia; and presents options for a renewed reform agenda.

The context of this research

The regulation of the Australian private rental sector directly affects about 40 per cent of Australian households: the 26 per cent who live in private rental housing as tenants, and the 14 per cent who own it as landlords. Reform of regulation of residential tenancies processes have recently concluded in NSW, Victoria and the ACT, and are currently underway in Queensland, South Australia, Western Australia and the Northern Territory. These processes, however, have mostly been uncoordinated at a national level, and significant divergences and gaps have opened up in the law.

The key findings

The private rental sector is more dynamic than it may appear from its steady growth trend of the past four decades. A large number of properties have churned through private rental. In recent years in Sydney and Melbourne, a majority of rental housing leaves the sector within five years of entering. Further, in both cities, more than 30 per cent of tenancies commence in properties that are entering the private rental sector, and more than 25 per cent of tenancy terminations coincide with the property exiting. An investor survey gives a similarly dynamic picture of frequent, multiple engagements in investment and use of rental properties for other purposes.

The small-holding, frequently-transferring character of the private rental sector presents basic problems for tenants trying to make homes in it.

Statistical analysis of property entries (investment) and exits (disinvestment) finds mixed evidence about the effect of two recent tenancy law reform episodes in NSW and Victoria. There was, however, no evidence of a 'disinvestment' effect in either jurisdiction.

Australian states' and territories' residential tenancies legislation is generally accommodating of the rental sector's property dynamics. Jurisdictions have reformed their tenancy laws over the years, but virtually without national co-ordination. Increasing legislative divergences and gaps could be addressed through a new national agenda for tenancy law reform. Governments can be unafraid of claims about 'disinvestment'. Indeed, it could be suggested that exit from private rental investment by landlords dissatisfied with tenancy law may even be a good thing: it could mean more space for owner-occupiers and different, better rental housing providers.

Household sector ('mum and dad') rental investors

The research survey of 970 current and previous property investors shows the large majority (76%) own their homes, either with a mortgage or without, and most (52%) live in households comprising a couple with dependent children —literally 'mums and dads'. The age profile of our sample is younger than that of other sources, with most aged under 40 years and only six per cent aged over 60 years.

The large majority of investors (91%) are employed either full- or part-time, and for 85 per cent, employment earnings are the primary source of household income. Rents are the primary income for only eight per cent. The household income profile of the sample is higher than the general population.

Half of current investors (50%) only own one investment property; of the rest, most own between two and five properties each.

For 70 per cent, their most recent investment property acquisition had been made in the past five years (2016–2021). Most of these (69%) acquired the property by purchasing it as an investment property, while over a quarter (26%) had turned the property they previously lived in into an investment property.

Over the preceding 12 months two-thirds (67%) said their property had been let as residential rental, while 20 per cent said it had been used by family members and 13 per cent said it had been used for short term letting market (13%).

'Rental income' was considered 'very important' by the largest portion of investors (61%), followed by 'potential capital gains' (52%). Tenancy law was also an important consideration: 'very important' to 44 per cent of investors, and unimportant to 11 per cent, with tax laws (39%) and planning and development laws (38%) also important.

The survey suggests that multiple-property landlords are less oriented to propositions of tenant service, and that landlords oriented to 'high-service' are still often motivated by investment objectives that involve transferring out of the private rental sector.

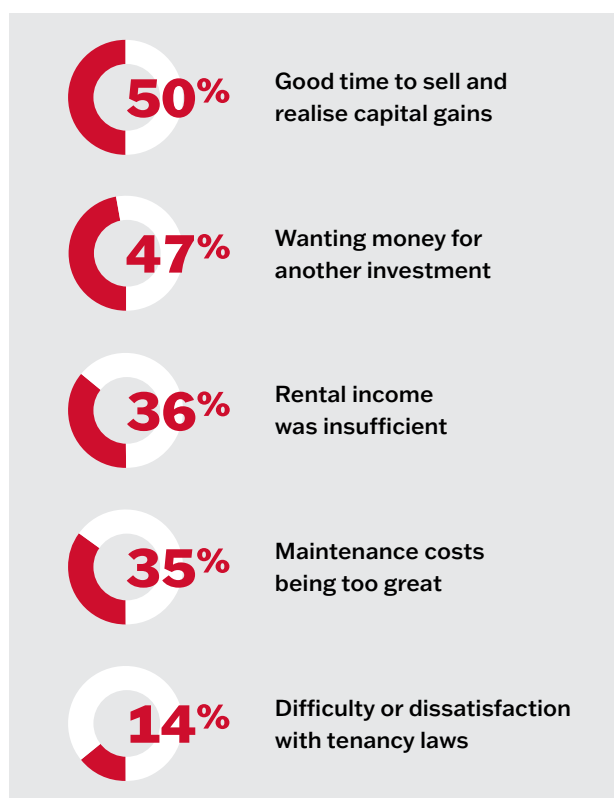
This highlights that there are risks for tenants in a market relying on the attitudes or dispositions of landlords for affordability, security and decent conditions. It would be appropriate for policy makers to consider greater legal protections.

Why household sector landlords sell

The reason most often nominated as 'very important' in investors' decisions to relinquish investment properties is that it was a good time to sell and realise capital gains (50%). This is profit-taking and indicates a successful speculation in the sector rather than disinvestment prompted by adverse circumstances. This reason is followed closely by wanting money for another investment, which was 'very important' to 47 per cent of investors and, again, not indicative of an adverse experience. The third and fourth most commonly cited 'very important' reasons are adverse ones: the rental income was insufficient (36%); followed by maintenance costs being too great (35%).

Tenancy law was less important in decisions to relinquish an investment property. A lower proportion of investors (14%) nominated difficulty or dissatisfaction with tenancy laws as 'very important' compared to any other factor, and 47 per cent say dissatisfaction with tenancy laws was not important at all.

Figure 1: 'Very important' reasons why investors decide to sell their investment properties



Source: AHURI Final Report No. 391.

Large corporate landlords and build-to-rent

The nascent build-to-rent sector (with large corporate landlords) is designed to operate on quite a different dynamic to non-corporate landlords, with properties and managers remaining in the sector long-term, while tenants enter and exit as they see fit (and likewise for investors in the corporate entities that own the buildings). Large corporate landlords are assumed to provide a more professional rental housing experience.

Prospects for large corporate landlords have recently opened up, through low interest rates and yield gap compression, and some modifications by states to land tax. However, build-to-rent is still tiny relative to the individual and household landlords.

The build-to-rent sector is establishing its customer service credentials, but its access technologies and its unusual presence in community relations and local rental markets pose potential problems.

Short term letting

The rise of the short term letting market is opening up prospects for properties to transfer into the tourism sector and into second home use, which is adding to private rental sector dynamism.

Australian residential tenancies laws, as well as regulatory settings relating to the short term letting market, accommodate landlords' use of the private rental sector as a site in which housing assets may be held, or re-deployed, according to investors' own circumstances and their assessment of opportunities and constraints emanating elsewhere.

Investors in the survey indicated a strong interest in the short term letting market. Just over half of current investors expressed an interest in using their property as short-term accommodation in the future, with 38 per cent saying they would 'probably' short-term let and 16 per cent would 'definitely'. The most common reason for these plans is the flexibility of short term letting (61%), while 54 per cent also believed that short term letting would generate more rental income than long stay residential rental.

The analysis supports the characterisation that Australian tenancy laws accommodate landlords.

Overview of Residential tenancies law

Each of the states and territories has its own residential tenancies legislation, broadly on a model of prescribed standard forms, terms, charges and notice periods; accessible dispute resolution; market rents; and ready but orderly termination. Every jurisdiction has things to learn from others and lessons to offer.

Previous AHURI research on private rental sector regulation in Australia and nine comparator countries found Australian states and territories were among the most lightly regulated as regards security of tenure, rents and registration of landlords. The Australian private rental sector gave little assurance of security and autonomy for tenants, and this was a function of laws, subsidies, market structures and cultural norms.

Residential tenancy law reform investment impacts

Two tenancy law reform interventions (the enactment of the Residential Tenancies Act 2010 (NSW), and the commencement of the 2015 Victorian Fairer Safer Housing review) were analysed to see whether they affected trends in properties entering (investment) and exiting (disinvestment) the private rental sector.

For the New South Wales reform, there was no effect on the trend of private rental sector entries, and a negative effect on the trend of private rental sector exits, i.e. there

were fewer exits after the reform. For the Victorian review, there was a negative effect on the trend for private rental sector entries, i.e. there were fewer entries after the review commenced, and no effect on private rental sector exits.

The analysis supports the characterisation that Australian tenancy laws accommodate landlords. While the prospect of reforms may cause some would-be investors to pause, the analysis does not support the contention that tenancy law reforms have caused landlords to disinvest.

'The private rental sector is more dynamic than it may appear from its steady growth trend of the past four decades.'

What this research means for policy makers

The research finds little evidence that Australian residential tenancies law has impacted investment in private rental housing. On the contrary, Australian residential tenancies law has accommodated, even facilitated, the long-term growth of the private rental sector and of its particular structure and dynamic character. Dominated by small-holding landlords who frequently transfer properties into and out of private rental according to their individual circumstances and wider housing market conditions, the Australian private rental sector is built for investing and disinvesting.

A national agenda for residential tenancy law reform

It is now almost 50 years since the Australian Government, through the reports of the Commission of Inquiry into Poverty, set the agenda for the law reform processes that eventually produced the residential tenancies legislation currently operating in all states and territories. Based on the findings of this report, the researchers argue it is time to pursue a new national agenda for residential tenancies law reform, with the following directions:

- **The RTAs and residential tenancy agreements:** Work could be done on a more consistent format for standard form residential tenancy agreements and, more importantly, for the RTAs themselves. A consistent modern definition of boarders, lodgers and other categories of renters excluded from the mainstream provisions could be agreed, and broad occupancy principles established for those categories without specific regulatory regimes. Whether fixed terms should be abolished could be investigated.

- **Access to rental housing:** A watching brief could be maintained on developments in information technology in rental housing, particularly involving third party intermediaries who might not otherwise be covered by provisions directed at landlords and agents. Discrimination in the provision of rental housing on grounds of source of income, status as a recipient of income support and status as an applicant for social housing could be prohibited. Consideration could be given to a prescribed standard form for tenancy applications. Registers for landlords could be established, and consideration given to qualifications and banning orders.
 - **Rent and other costs:** An investigation could be made into contemporary rent regulation regimes that moderate increases in market rents (e.g. by reference to CPI, administratively determined guidelines, or local reference rents), including their effectiveness and respective data requirements.
- ‘Previous AHURI research on private rental sector regulation in Australia and nine comparator countries found Australian states and territories were among the most lightly regulated as regards security of tenure, rents and registration of landlords.’
- **Tenants’ quiet enjoyment, privacy and household autonomy:** Appropriate penalties could be devised for breach of quiet enjoyment, and provision made for compensation for loss of enjoyment. Terms that unreasonably restrict the number of members of the tenants’ household could be prohibited. Consideration could be given to allowing tenants to keep pets and make minor alterations without approval. The scope of prescribed reasons for landlords accessing the premises could be investigated, as could schemes for bargaining over access and compensation for loss of enjoyment when a property is advertised for sale.
 - **Dwelling conditions, repairs and alterations:** The obligation of landlords to provide and maintain premises in a habitable condition could be clarified in consistent minimum standards, and augmented by specific additional requirements in identified priority areas for improvement (e.g. electrical safety devices and energy efficiency standards).
 - **Termination and eviction:** Termination by landlords could be on prescribed grounds only; without-grounds termination could be abolished. The tribunals could be afforded discretion to decline termination; how this discretion is most appropriately structured (e.g. by factors for specific consideration) could be investigated.
 - **Dispute resolution and the tribunals:** An investigation could be made into how to appropriately balance use of preliminary procedures (including by other executive agencies) that divert from the tribunal, ordinary proceedings in the tribunal and more formal proceedings that produce written reasons. The tribunals’ lack of jurisdiction in matters involving interstate landlords is difficult to reform, because of its constitutional basis. Consideration could be given to requiring landlords to disclose to prospective tenants if they reside interstate and the jurisdictional consequences thereof.
 - **Family and domestic violence:** Provision could be made for tenants to give a termination notice on grounds of family and domestic violence, certified by an appropriate person, and leave without further liability. Vicarious liability could be qualified such that tenants are not liable where a breach arises from family and domestic violence against the tenant.

Methodology

This research analysed rental bonds of properties entering and exiting the private rental sector in Sydney and Melbourne over a 20-year period (2000 to 2020); interviewed private rental sector experts and stakeholders; undertook an online survey of property investors (n 970) and reviewed Australian residential tenancies law.

To cite the AHURI research, please refer to:

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Available from the AHURI website at ahuri.edu.au/research/final-reports/391