EXECUTIVE SUMMARY

PEER REVIEWED

FINAL REPORT NO. 432

Incentivising small-scale investors to supply affordable private rental housing

Authored by
Akshay Vij, University of South Australia
Andrea Sharam, RMIT University
Kingsley Baako, RMIT University
Ali Ardeshiri, University of South Australia
Debbie Faulkner, University of South Australia
Lynette Washington, University of South Australia
Wejandra Reddy, RMIT University
Braam Lowies, University of South Australia

Publication Date November 2024
DOI 10.18408/ahuri3231601

AHURI

Title

Incentivising small-scale investors to supply affordable private rental housing

Authors

Akshay Vij, University of South Australia
Andrea Sharam, RMIT University
Kingsley Baako, RMIT University
Ali Ardeshiri, University of South Australia
Debbie Faulkner, University of South Australia
Lynette Washington, University of South Australia
Wejandra Reddy, RMIT University
Braam Lowies, University of South Australia

ISBN

978-1-922498-99-1

Key words

affordable private rental housing schemes; property investors

Series

AHURI Final Report

Number

432

ISSN

1834-7223

Publisher

Australian Housing and Urban Research Institute Limited
Melbourne, Australia

DOI

10.18408/ahuri3231601

Format

PDF, online only

URL

https://www.ahuri.edu.au/research/final-reports/432

Recommended citation

Vij, A., Sharam, A., Baako, K., Ardeshiri, A., Faulkner, D., Washington, L., Reddy, W. and Lowies, B. (2024) *Incentivising small-scale investors to supply affordable private rental housing,* AHURI Final Report No. 432, Australian Housing and Urban Research Institute Limited, Melbourne, https://www.ahuri.edu.au/research/final-reports/432, 10.18408/ahuri3231601.

Acknowledgements

This material was produced with funding from the Australian Government and state and territory governments. AHURI Limited gratefully acknowledges the financial and other support it has received from these governments, without which this work would not have been possible.

AHURI Limited also gratefully acknowledges the contributions, both financial and in-kind, of its university research partners who have helped make the completion of this material possible.

Executive summary

Key points

- Small-scale investors can be incentivised to enter the affordable housing market through financial incentives that prioritise positive cashflow.
- Make-good provisions that ensure property is returned to the landlord in original condition will increase participation in affordable private rental schemes.
- Communication and education programs will increase successful long-term participation.
- Headleasing is an effective way to attract small-scale investors and increase affordable rental housing stock.
- Small-scale investment-support schemes should prioritise long-term hold investors over 'flippers' and short-term lets.
- Community housing providers are preferred over private investors, however they are unable to provide the quantity and diversity of housing stock required to meet demand.

Key findings

The Australian housing market is experiencing both long-term structural changes and short-term pandemic impacts. The result is rising rents and very low vacancy rates as demand for rental housing outstrips supply—particularly for low-income households (Reynolds, Parkinson et al. 2024). The private rental sector has become the fastest-growing part of the Australian housing system, outstripping household growth since 2001 (Hulse, Reynolds et al. 2019).

This research seeks to understand how governments might incentivise small-scale investors to provide affordable rental housing. We used a mixed-methods approach, incorporating a quantitative survey of 800 small-scale investors, in-depth interviews with small-scale investors, and focus groups with policy makers to identify potential policy options. The survey sample is broadly representative of small-scale investors in Australia, however our sample tends to be younger and have higher incomes than the average Australian small-scale investor. The qualitative engagement we conducted comprised relatively small sample sizes; it was used to refine and contextualise the survey results.

Positive cashflow

As a group, small-scale investors own the majority of residential rental dwellings in Australia, but generally own only one to two investment properties each. These investors are highly sensitive to short-term cashflow; approximately 46 per cent of survey respondents ranked positive cashflow as their most important investment strategy. Long-term hold investors (LTHI) are impacted by unexpected extrinsic financial factors—such as rising interest rates and tenant vacancies—and could not afford to be negatively geared when they experienced financial hardship. Rental guarantees are also important to this group; they are 12 per cent more likely to participate in a scheme that offers guaranteed rental income. Similarly, our qualitative engagement found that this group values indexing rents to market rates. Incentives that prioritise cashflow will motivate this large group of investors.

Make-good provisions

Aside from the risk associated with cashflow issues, tenant behaviour was considered a key risk for many landlords. Landlords noted that bad tenant behaviour could derail their investment through:

- increased maintenance costs
- high tenant turnover
- legal costs associated with tenancy disputes.

Unsurprisingly, landlords expressed a preference for tenants with financial capacity and no propensity for property damage. While these landlords were sensitive to tenants' needs, they entered the property market for financial gain rather than to address social inequity. Therefore, schemes designed to entice them into affordable housing must provide confidence that appropriate tenants will be sought and make-good provisions enacted.

Make-good provisions guarantee that a property will be returned to the landlord in original condition at the end of a lease period. These agreements are important in headleasing. (Headleasing is when a housing agency rents private rental property from a landlord/owner and then on-lets that property to a tenant experiencing disadvantage.) Headleasing programs that include make-good provisions can incentivise investors to participate in affordable housing programs. However, such provisions can be expensive, costing on average $40,000 to restore a property to original condition. This means that headleasing can be a costly option.

Acquiring the funds to make good a property is challenging. Some community housing providers (CHPs) withhold a percentage of the rent to make good at the end of the lease, and others obtain funds from government subsidies—although these subsidy programs are viewed as grossly underfunded. While make-good provisions are costly, they represent an important opportunity to incentivise investors. Our survey showed that the average investor in our sample is 7 per cent more likely to participate in a scheme that offers make-good provisions than one that does not. Furthermore, the average investor would be willing to forego roughly $7,150 in annual tax rebates if a make-good provision was in place.

Affordable housing schemes

Our research found that 81 per cent of investors engaged in affordable housing schemes found them satisfactory, and between 40 and 60 per cent of respondents would be willing to participate in a scheme such as headleasing or the National Rental Affordability Scheme (NRAS). Despite this, only 39 per cent of small-scale investors in our sample were engaged in these schemes. Our qualitative research found that there were poor levels of awareness of affordable housing schemes. However, when investors became aware of such programs, they were interested in participating in them.

Furthermore, we found that the investment sophistication of long-term hold investors varies considerably; some are naïve and are negatively impacted by unexpected extrinsic financial changes that can cause them hardship. These investors present a risk to stability in the affordable housing sector. Due to lack of financial literacy, they may overcommit to their investment property, and experience financial hardship and be forced to sell the property when hit by unexpected extrinsic financial factors such as interest rate rises or extended periods without a tenant.

Headleasing

Focus groups and workshops with social housing providers, policy makers and small-scale landlords found that headleasing is an effective way to engage with small-scale private investors in the social and affordable housing ecosystem. Headleasing schemes avoid the need for major capital investment from CHPs and they increase and diversify the available affordable housing stock.

Headleasing is very attractive to private investors, but awareness of the option appears low among landlords. Landlords were unanimous in their support for headleasing schemes; most received market rent and were not exposed to risk. Benefits were fourfold:

- Guaranteed rental payments provided cashflow security—such rental guarantees made investors 12 per cent more likely to participate in a scheme.
- No loss of rent due to vacancy, and no need to advertise for new tenants.
- Guaranteed make-good provisions provided confidence that the property would be returned in original condition.
- Reduced administration demands when the property management was signed over to the social housing provider (SHP) provided peace of mind and a ‘hands free’ approach.

Regardless of these advantages, headleasing schemes do have drawbacks. In particular, landlords noted that indexing rents to market prices would increase their satisfaction with the scheme. As the schemes are designed to minimise landlord risk, they expose SHPs to considerable financial risk and are expensive to run. Headleasing schemes require an operating subsidy to meet the gap between market rent and social rent—which can be prohibitive for SHPs. Furthermore, while headleasing is viewed as popular, it is not suitable for tenants:

- with high needs
- escaping family and domestic abuse
- at high risk for property damage.

Small-scale investors

Small-scale investors present potential risks for affordable housing investment. Our qualitative engagement suggests that 'flippers', those who buy properties and quickly sell them for a profit, may create instability and inflate prices. However, it should be noted that our sample size was small. Similarly, investors engaged in short-let rentals through companies such as Airbnb inflate housing prices and create housing stress in areas with high tourist demand, especially in large inner-city urban areas in Melbourne and Sydney. Although flippers and short-let landlords are a relatively small cohort, they do have a negative impact on the affordable housing ecosystem. Long-term hold investors can also create instability if they face financial hardship. However, this only occurs in a small number of cases, and these investors are largely sensitive to tenants' needs and provide greater stability. For this reason, long-term hold investors are the preferred investors in the affordable housing landscape.

Community housing providers

Finally, our qualitative analysis found that CHPs were preferred over private investors due to the stability they provided and their capacity to mitigate the risks associated with private investment. However, CHPs do not have the capacity to invest in affordable housing at the scale required to address current and future predicted shortfalls. Therefore, long-hold private investors should be prioritised to meet demand and provide the quantity and diversity of housing stock that is required.

Policy development options

Who should be incentivised to provide affordable private rental housing?

All small-scale investment in affordable housing carries risks; these risks vary depending on the investor type.

Short-term hold investors often purchase higher-value properties with an intention to sell quickly at an inflated price ('flippers'). There is potential for these investors to inflate property prices and cause rental instability.

Long-term hold investors are more likely to provide stability and are therefore the more desirable target of government incentives. However, they also carry risk, primarily associated with a lack of financial knowledge; this can lead to failed investments and the need to sell the investment property in unplanned circumstances—especially because of extrinsic financial conditions such as interest rate rises.

Due to the risks associated with small-scale investors, it was noted that CHPs were the preferred target of government subsidies and programs. CHPs were seen to provide greater stability and fewer risk factors. However, CHPs do not have the capital capacity to provide an adequate supply of diverse affordable housing stock. Therefore, government policies aimed at incentivising long-term hold small-scale investors are preferred.

Incentivising small-scale investors through financial incentives

Long-term hold small-scale investors are incentivised by schemes that maximise the potential for a positive cashflow—not by financial schemes such as negative gearing and capital gains tax concessions. Our survey found that the average small-scale investor would need a tax offset of approximately $650 per year for every 1 per cent of market discount provided. These investors also value schemes that assure rental income, which underscores the importance of positive cashflow to this group. Furthermore, our qualitative analysis found that it is important to index rental increases to market rates so that investors who lock-in to long-term schemes are not disincentivised. Therefore, any programs designed to entice long-hold small-scale investors must prioritise incentives that support positive cashflow—for example, through rental guarantees and rents that are indexed to market rates.

Incentivising small-scale investors through make-good provisions

Make-good provisions provide landlords with confidence that their property will be returned to them in original condition at the end of the lease. Given landlords' concerns about social housing tenants, make-good provisions are a critical aspect of a social housing program that engages with the private rental market. Make-good provisions will incentivise landlords to participate in programs such as headleasing. However, make-good provisions are expensive, and acquiring the funds to make good a property is challenging. CHPs have the option to fund make-good provisions through retaining a portion of the rent or by obtaining government subsidies. Current government subsidy programs are grossly underfunded, and any such program should reflect that on average it will cost around $40,000 to make good a property at the end of the tenancy. Providing CHPs with access to adequate make-good funding subsidies will increase small-scale private investment in affordable housing.

Using effective communication and education programs to encourage appropriate investors

Low levels of awareness of schemes such as NRAS or headleasing has led to low levels of participation and affordable housing targets not being met. However, when small-scale investors do engage with affordable housing schemes, their satisfaction levels are high. A coordinated national marketing and education program targeting small-scale, LTHI to increase awareness of incentive schemes could improve participation in these schemes. Furthermore, our research found that if small-scale investors are not financially savvy, they can increase instability in the affordable housing sector, causing disruption for tenants. Education programs aimed at improving financial literacy among this group of investors could filter out vulnerable investors before they enter the affordable housing market, thereby minimising disruption caused by financial overcommitment. Adjusting prudential regulations could also support the goal of filtering out inappropriate investors.

Using headleasing to lure short-term lets into the affordable housing market

While media attention often focuses on the idea that short-term lets (STLs) on platforms such as Airbnb have a negative impact on housing, our research has shown that the impact of STLs is mainly in popular tourist destinations and some large inner-city urban areas, such as Melbourne and Sydney. That said, housing affordability is a significant concern in both tourist destinations and inner cities—especially for essential workers—and there is scope to incentivise small-scale investors in these problematic areas to move into the affordable private rental market.

Our policy workshop participants agreed that headleasing schemes that promote social and financial incentives have been successful in luring investors away from STLs in Tasmania. However, these schemes have had to provide broad-ranging and significant financial incentives addressing the rental gap, tenancy management fees and rental guarantees, as well as covering property damage. Despite the sizable costs of these schemes, they may be warranted in areas where short-lets create considerable housing stress. Our survey found that only 2.6 per cent of respondents favoured STLs as their most important investment strategy, and this suggests that a large proportion of small-scale investors could be drawn away from short-lets if the incentives meet their cashflow priorities.

The study

This project examined how governments at different jurisdictional levels can incentivise the provision of affordable rental housing by small-scale investors. Nearly one-third (31%) of Australian households rent their residential dwelling, and housing affordability is a particularly acute concern for low-income and middle-income households in the private rental sector (Australian Bureau of Statistics [ABS] 2021). Among other measures, governments have sought to address the issue by incentivising greater small-scale investment in the supply of affordable rental housing through the use of tax benefits, regulatory concessions and other policy levers. These efforts have had limited success, and incentivising small-scale investment in affordable private rental housing remains a challenge.

We reviewed national and international evidence on past and current affordable private rental housing schemes to identify factors that have contributed to their success or failure. We conducted qualitative interviews and focus groups with 40 small-scale investors and 10 asset managers across Australia to understand motivators for (and barriers to) small-scale investment in affordable rental housing. Furthermore, we undertook a nationwide online survey of 800 small-scale investors to quantify the marginal effect and relative importance of regulations, tax benefits and other policy levers that seek to design cost-effective incentives. Such incentives are intended to provide tangible and durable affordability benefits to encourage greater investment by small-scale investors in both regional areas and major cities, and to demonstrate economic and social payoff to governments. Finally, we held a workshop with nine policy makers to examine the efficacy and feasibility of different policy options.

Our research focussed on four research questions:

1. How have previous and existing affordable small-scale private rental housing schemes performed in Australia and internationally? What factors have contributed to their success or failure?
2. What are the motivators for and barriers to small-scale property investors investing in affordable rental housing?
3. What are the impacts of regulations, taxes, and other policy levers on small-scale investment in affordable rental housing?
4. How can governments at different jurisdictional levels incentivise the provision of affordable rental housing by small-scale investors?

This report synthesises findings from our analysis and identifies potential policy mechanisms that could be used to incentivise small-scale investment into the affordable private rental housing market. It includes specific policy recommendations directed at different levels of government.

Australian Housing and Urban Research Institute
Level 12, 460 Bourke Street
Melbourne VIC 3000
Australia
+61 3 9660 2300
information@ahuri.edu.au
ahuri.edu.au
twitter.com/AHURI_Research
facebook.com/AHURI.AUS
Australian Housing and Urban Research Institute