



## EXECUTIVE SUMMARY

# Private rental in transition: institutional change, technology and innovation in Australia

Inquiry into the future of the private rental sector

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Simon Cohen	Department of Justice and Regulation, Victorian Government
Hanna Ebeling	Social Enterprise Finance Australia Ltd
Nick Foa	Department of Health and Human Services, Victorian Government
Louise Gilding	Community Services Directorate, ACT Government
Heather Holst	Launch Housing
Jill Mills	Department of Social Services, Australian Government
Jaqueline Phillips	Australian Council of Social Service
Lydia Ross	Department of Social Services, Australian Government
Erin Turner	CHOICE

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# Executive summary

## Key points

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- The Australian private rental sector (PRS) increased by 38 per cent over 10 years (2006–16), more than twice the rate of household growth.
  - 2.1 million Australian households lived in the private rental sector (PRS) in 2016 or 26 per cent of all households.
  - Debt-financed investment in PRS dwellings has increased with a 42 per cent increase in the volume of lending to investors over 10 years (2006–16), with lending for investment at times exceeding lending for owner occupation.
  - 1.135 million Australian households were investor landlords in 2013–14, 72 per cent owning one property, with some increase in multi-property landlords.
  - PRS properties under management by real estate agents increased nationally from 68 to 75 per cent 2006–16, with differences between cities—Sydney (81%); Melbourne (79%) and Perth (66%).
  - Increased growth and diversity of the Australian PRS in the 2000s has been associated with institutional change, including new types of organisations, technologies and practices.
  - There is an increase in the number and type of intermediary organisations involved in all aspects of the PRS: financing, provision, access and rental property management.
  - Global and Australian real estate companies and developers are entering the PRS with rental yield models such as off campus student housing and the proposed build-to-rent model.
  - Uptake of new technology within the PRS has been extensive, including online property, specialist sharing and generalist portals, and property management software which collects more data on private renters, providing considerable benefits, but also increasing risks of data use for screening for eligibility, ranking applications and targeted selling of additional products and services.
  - Practices in the PRS are changing with real estate market restructuring, the uptake of new technology and outsourcing to third parties; indicating some change from administrative processing to service provision, although this change in modus operandi also requires a cultural shift.
  - While many PRS activities have been viewed as issues of regulation, there are clear signs of the need to reconnect regulation with policy goals in the context of institutional change and the emergence of new technologies and business models.
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## The policy issue

The private rental sector (PRS) is the fastest growing part of the Australian housing system. Previous research has shown that the PRS is no longer a transitional sector for younger people between leaving the family home and becoming home owners. There are now more private renters on lower *and* higher incomes, more households with children; more households renting at mid-life, and more long-term renters (10+ years).

The PRS is critical to the success of a range of public policies. Housing assistance policies rely on good outcomes in the PRS to prevent homelessness; manage demand for social rental and enable movement out of the social rental sector; as well as enabling those in receipt of rental assistance to access affordable housing. Broader reforms of social policy for people with disability and older people rely on the PRS to provide accommodation in conjunction with various support and care packages. The PRS also provides accommodation for people in a wide range of other circumstances, including international students and new migrants.

A critical policy issue in view of these trends is the extent to which the PRS enables good outcomes for a diverse group of households, including those renting for short/medium/long periods; those on low/medium/high incomes; and a variety of household types. Research to date has indicated that while the PRS provides a range of accommodation types in different locations, there are ongoing concerns about outcomes for private renters. These include: lack of affordable supply, frequent rent increases, lack of security, prohibitions that limit home-making (such as on pet ownership) and varied experiences of housing quality and services.

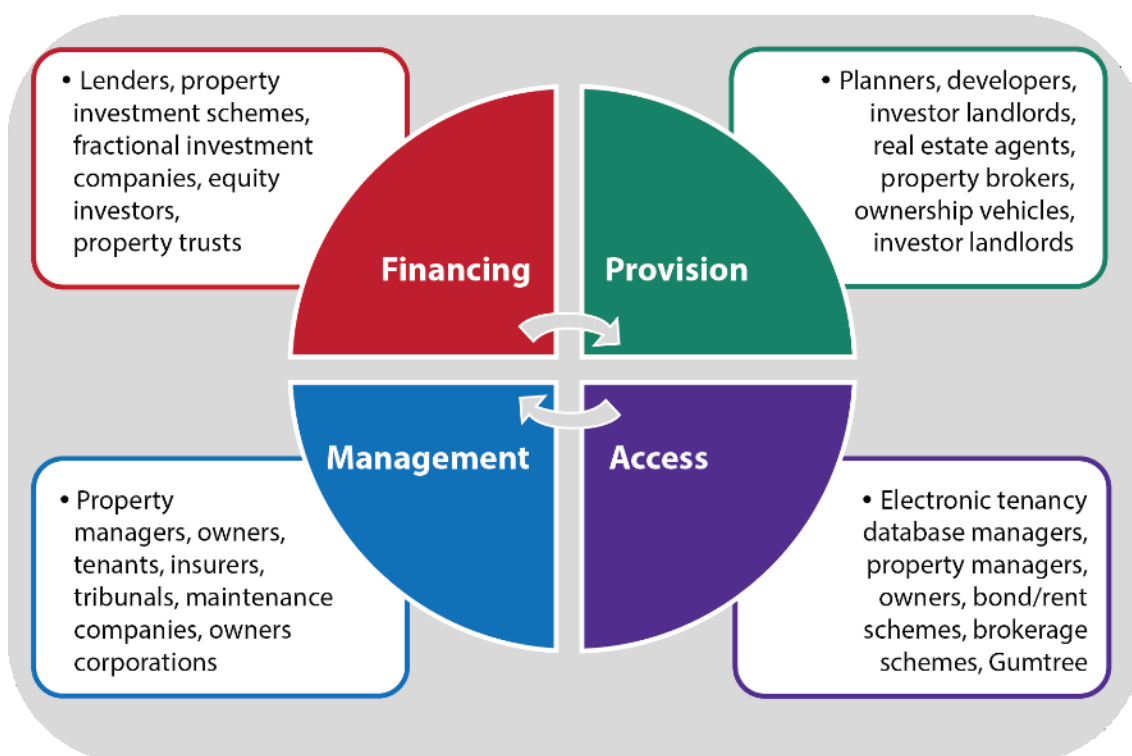
This Final Report presents a *comprehensive institutional analysis* of the PRS, which explores the interplay between i) regulation, ii) organisations and structures and iii) social norms and practices in the context of prevailing policies on the PRS. It provides a critical and empirical investigation of the conventional categories which shape understanding of the PRS through exploring a much fuller range of organisations involved in the sector as well as the impact of innovation and digital technology. Through focusing primarily on sector/industry changes, it provides a different perspective on the PRS to existing research which centres on government policy settings and resident experiences.

## Key findings

Within the overall framework of policies, regulation, organisations and structures, and social norms and practices, the research investigated four interrelated dimensions of the PRS as illustrated in the Figure below—financing, provision, access and management. The key findings are organised in this way.



**Figure 1: Key dimensions of the institutional structure of the Australian private rental sector**



*Note: These are example of organisations in the PRS and are not exhaustive or mutually exclusive.*

Source: Authors.

## Financing

Housing finance for PRS investment increased by 42 per cent in real terms 2006–16 (compared to an 8.4% increase in lending for owner occupation); indicating the growing importance of debt rather than equity financing of the PRS, with a particular increase in interest-only loans. Lending for rental investment surged to new highs briefly in 2003–04 and then in a more sustained way during 2013–17, largely for established rather than new housing.

These trends have been seen predominantly as issues of regulation.

- The policy lever of choice has been macro-prudential regulation. Interviewees for the project considered that this type of intervention produced mainly short-term effects, since other factors were important to investor landlords including low interest rates ('cheap money'), expectations about capital gains, and taxation regimes.
- There were differing views on foreign investment in the PRS, with the Australian Government implementing tighter controls on this type of investment. Those interviewed for the project considered that these controls dampened down demand in the apartment construction sector affecting pre-sales.

There has been a proliferation of intermediary organisations between lenders and investor landlords, including various types of financial intermediaries and wealth advisors.

- Financial intermediaries provide linking services to connect the investor landlord with a lender (including mortgage referrers, mortgage brokers and mortgage aggregators<sup>1</sup>), with each intermediary receiving remuneration for their role.
- Wealth advisors have been active in recommending debt-financed rental property investment to households and providing services to facilitate this.

Innovation in PRS financing through schemes in which investor landlords purchase a part of the housing asset (known as fractional investment) has the potential to be 'disruptive', although those interviewed for the project generally took a 'wait and see' attitude.

There are signs of change in social norms and practices, with more landlords seeing themselves as investors, manifest in more deliberate strategies to purchase property for rental (rather than incidental ownership through inheritance or renting out a property which was their former home). More purposive investment of this type has been associated with a rise in 'borderless investment', based on assessment of the potential of different housing markets to deliver capital gain and rental yields.

## Provision

Households are still the primary providers of PRS housing in Australia. The typical investor landlord is an owner-occupier, at midlife, in a household with two incomes, although one in eight themselves rent in the PRS.

- Although PRS ownership is quite widespread, there is a concentration among higher income and higher wealth households.
- Investor landlords have an estimated two-thirds of their assets in property, but their debt-to-asset value appears quite conservative in most cases.
- The percentage of households with more than one rental property appears relatively stable at just under 30 per cent (with some disparity between data sources) but the multi-property investor share of all PRS properties has increased.

There has been a growth in intermediaries such as buyer's agents and property advisory services which help shape PRS provision by households.

Innovation in the sector comes primarily from debt financing based on rental yield or cash flow models of purpose-built rental accommodation that cannot be strata titled<sup>2</sup> and sold as separate units:

- New generation boarding houses facilitated by changes in state planning provisions (NSW).
- Student housing involving large corporate providers, which is significant in Melbourne and Sydney and to a lesser degree in Perth.
- Global and Australian real estate companies' proposals to introduce a new build-to-rent (or multi-family) model in Australia, with high density, purpose-built rental housing.

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<sup>1</sup> Mortgage referrers (e.g. real estate agents, financial planners, lawyers and accountants) refer the investor landlord to a lender; mortgage brokers are specialists in arranging finance for the investor landlord from a lender typically via a mortgage aggregator who provides technology, administrative support and training for mortgage brokers.

<sup>2</sup> Strata title is an Australian property innovation from the early 1960s which enabled individual ownership of dwellings in multi-unit buildings along with shared ownership of common property (e.g. driveways, foyers and gardens) through a legal entity known in different Australian states as an owners' corporation, body corporate, strata company or community association (Strata Community Association, What is Strata?, <https://www.strata.community/understandingstrata/what-is-strata>.)

## Access

Many organisations are involved in the tenant PRS access process—the media *facilitates* access, residential tenancy databases are used to *check* access through screening applicants, and managing agents do both. Current regulation focuses primarily on those who check and manage access.

Dynamic changes in PRS institutions are associated with more widespread development and the adoption of digital technology is affecting all parts of the access process.

- There has been considerable institutional change in *advertisement* of PRS properties through major online portals, specialist sharing portals and general online classified advertisements, casting a wider net for prospective tenants and providing greater property information, including photos, floor plans and location relative to transport and jobs.
- At the *application* stage, software enables one application (rather than multiple applications for multiple properties) and more streamlined property viewings with benefits for prospective tenants and managing agents. There are also risks in these developments in the amount and type of data collected, which go well beyond the rental tenancy databases that are currently regulated, including data use for targeted advertising, ranking tenants, and selling additional products and services.
- At the *offer* stage, online reputation analysis technology<sup>3</sup> is already being launched in Australia with an alternative bond product in association with landlords' insurance. It appears that there is also some 'upselling'<sup>4</sup> of additional products/services to new tenants such as internet access and contents insurance.

## Management

The increase in management of PRS properties by real estate agents in 2006–16 is associated with more purposive investment and an increase in properties not in close proximity to the investor landlords' own residence (termed 'borderless investment').

Rental property management has become more important to real estate agents because it is a source of stable revenue which covers an increased proportion, if not all, of the fixed costs of the business, enabling agencies to weather the volatility of housing sales since the Global Financial Crisis.

Restructuring of the real estate industry to achieve economies of scale has involved change in rental management activities through:

- The increasing size of rental portfolios under management, commonly referred to as 'rent rolls', both organically but also by mergers and acquisition, the latter involving specialist rent roll brokers and raising finance against the value of a rent roll in predominantly off-market transactions
- Investment in information and communications technology and use of third parties for aspects of management including 'virtual assistants'<sup>5</sup>, property condition reports, rent collection/receipting, maintenance workflow and property inspections, including those required at the end of a tenancy to assess any maintenance deemed necessary beyond

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<sup>3</sup> Online reputation analysis technology automatically collects and assesses online data, including reviews, ratings and 'likes', about individuals to determine their credibility.

<sup>4</sup> Upselling refers to the practice of attempting to sell products or services to a consumer in addition to the one that they have already agreed to purchase.

<sup>5</sup> 'Virtual assistants' is a term used in the real estate sector to denote routine activities outsourced to other people or organisations who are not located in the real estate office.



normal wear and tear to support any part/whole retention of bond monies. Some of this work is now conducted off shore.

There appears to be a slow change in social norms and practices, with agents reporting that some tenants have greater expectations in terms of service, including more timely, transparent and accurate information about response to their requests. The need for greater professionalisation in rental property management was a common theme in the research, including from those currently working within the sector.

## **Policy development options**

### **Financing and provision**

The key issues around financing and provision revolve around the benefits and risks of debt-financed provision by households vis-a-vis other models.

- Independent information for potential investor landlords based on evidence of housing market performance, the role and remuneration of financial intermediaries, and innovative lending products, would assist in building levels of financial literacy. Dependence on debt-financed PRS provision by households enables growth and provides housing system flexibility, but also carries risks for individuals/households in the event of a housing market and/or economic downturn.
- It is important to articulate expectations of investor landlords as housing providers. Investor landlords could be expected to apply the same diligence to their purchase and ongoing financial situation as other businesses providing services. Policy discourse should represent investor landlords as housing providers rather than ‘mums and dads’, which arguably diminishes expectations of them.
- Detailed assessment of the opportunities and risks associated with a build-to-rent model in Australia is essential. This work should consider whether build-to-rent complements, or is viewed as a market-driven alternative to, current work on enabling cheaper and more reliable finance for not-for-profit providers through a bond aggregator model. The focus should be on outcomes relative to any government contribution in terms of subsidies, concessions or tax expenditures.
- Developing a better, evidenced-based understanding of PRS financing and provision through improved data on foreign ownership of residential property for rental and PRS properties held by Self-Managed Superannuation Funds (SMSFs), trusts and other intermediary structures.

### **Access and management**

Technological advances have opened up possibilities for new types of institutions and business models for access and management, requiring policy development work:

- It would be timely for Australian governments to conduct a thorough review of current and emerging information technologies and practices in the PRS, particularly in relation to access. This would enable assessment of the adequacy of current regulatory regimes, and could result in placing reasonable limits on data collection and ensuring transparency in its use.
- A comprehensive view of the ‘renting by room’ sector would appear appropriate, to include issues such as the trustworthiness of online matching portals, change in occupancy use of premises and change in building structures to enable multi-room renting.

- The development of alternative bond products may have some potential benefits for tenants in accessing PRS housing but also raises some concerns, indicating a need for policy development in this area.
- The effectiveness of regulatory approaches to residential tenancies vis-a-vis other policy instruments should be reviewed, with a view to learning between jurisdictions and nationally. One option would be for the Australian Government to revisit national minimum standards in this area as part of its negotiations with the states/territories about a new National Housing and Homelessness Agreement.

## The study

The overarching research question that this Final Report addresses is:

*What are the dynamics and drivers of emerging trends in the institutions of Australia's private rental sector and what are the consequent opportunities and challenges for the sector?*

Three sub-questions were developed to guide the research:

- What changes have occurred in the institutions of Australia's PRS since 2000?
- What drivers and dynamics underlie the key institutional developments in the Australian PRS since 2000?
- What opportunities do new and changing institutions in Australia's private rental sector create for achieving better PRS outcomes and what are the main challenges to their achievement?

The comprehensive institutional analysis deployed in this study involved identifying, analysing and synthesising multiple sources of data and information on change in the Australian PRS in the 2000s to present a national overview with some focus on three cities (Sydney, Melbourne and Perth). An initial scan of the academic and grey literature on the PRS identified established and new institutions, and a preliminary categorisation helped shape the conceptual framework for the project. Analysis of secondary data sets relevant to the PRS was undertaken, in particular on households as investor landlords and as private renters: the ABS Census of Population and Housing 2016 (and previous years); the ABS Survey of Income and Housing (SIH) and supplementary analysis from the 2014 wealth module of the Household, Income and Labour Dynamics in Australia (HILDA) survey.<sup>6</sup> Forty-two interviews were conducted with informed people involved in all aspects of the PRS (financing, provision/development, access and management). The interviews also elicited further grey literature and industry intelligence, which assisted in preparing a comprehensive picture of institutional change in the Australian PRS.

This report focuses on institutional change and the selection of interviewees had an industry focus. A companion project for the Inquiry examined in detail the ways in which lower income and vulnerable households navigate the PRS in the context of institutional change from the perspective of private renters and the agencies that provide them with support (Parkinson, James et al. 2018). A third project examined institutional change in the PRS in 10 countries, enabling change in Australian institutions of the PRS to be viewed in a wider focus (Martin, Hulse et al. 2018). The Inquiry's Final Report will provide a high level analysis of key issues for the future of the PRS based on the three research projects and informed by two meetings of the Inquiry Panel.

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<sup>6</sup> HILDA is managed by the Melbourne Institute for Applied Economic and Social Research (University of Melbourne) and financially supported by the Australian Government.

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AHURI undertakes evidence-based policy development on a range of priority policy topics that are of interest to our audience groups, including housing and labour markets, urban growth and renewal, planning and infrastructure development, housing supply and affordability, homelessness, economic productivity, and social cohesion and wellbeing.

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