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Mr Trung Luu
Chair
Legislative Council Legal and Social Issues Committee
Parliament House
Spring Street
EAST MELBOURNE VIC 3002

7 July 2023

Dear Mr Luu,

The Property Council of Australia provides this submission to the Legislative Council Legal and Social Issues Committee Inquiry into the rental and housing affordability crisis in Victoria, issued on 7 June 2023.

The Property Council of Australia welcomes the opportunity to provide input into ongoing policy development and improvements in this area and has been active in policy options for supporting the supply of new housing, including affordable housing.

Addressing the enormity of this challenge requires involvement from all levels of Government and industry, noting our members play a significant role in developing the new homes required to solve the housing crisis.

The Property Council is the leading advocate for Australia's property industry; an industry that accounts for 13 per cent ($202.9 billion) of Australia's GDP, and the largest Australian employer, contributing to over 1.4 million employees.

In Victoria, property contributes $58.8 billion to Gross State Product, making up to 13.8 per cent of the Victorian economy. It employs one in four working Victorians, employing more than 390,000 people directly and supporting more than 471,000 workers in related fields. It pays 59 per cent, or $17.9 billion, in tax revenue, and pays more than $21 billion in total wages and salaries per year, being approximately 27.9 per cent of wages and salaries paid to Victorian workers.

Our members develop, invest in, design, build and manage the places that matter most to Australians – our homes, shopping centres, office buildings, industrial areas, retirement villages, education, research and health precincts, tourism, and hospitality venues and more.

Our members are delivering thousands of new homes each year in Victoria. Through this iterative process and with frequent discussion with industry and policy makers, our response

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and ongoing dialogue on housing supply and affordability is aimed to ensure future policy changes are practical for developers, and the wider property industry, so the industry can be fully armed to actively address the shortage of homes in the market.

This response provides some general commentary on impediments and solutions to housing supply and affordability, with a focus on the rental market, which have been informed by with some of our key industry committee representatives across build to rent, planning, infill housing, retail and precincts.

We have sectioned this into an introduction and key theme responses as per the Terms of Reference. We would welcome the opportunity to provide more information or to answer any questions at a committee inquiry hearing.

For more information or to clarify anything contained within this response, please contact [redacted]

Yours sincerely,

[redacted]

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Introduction

The Committee has outlined it will:

> *"investigate the challenges facing Victorian renters and factors causing the rental and housing affordability crisis in Victoria including low availability and high costs of rental properties, insecurity, availability and affordability issues facing Victorian renters, the adequacy of regulation with regards to standards and conditions of rental housing, the adequacy of the rental system and its enforcement, the impact of short stay accommodation, barriers to first home ownership and the impact this has on rental stock and the experience and impacts all of this has on renters and property owners."*

Statistics published by SQM Research showed that in May 2023, Melbourne had a residential rental property vacancy rate of 1.2 per cent, down from 4.8 per cent[1] in April 2020, two years earlier.

Victoria's rental market is highly reliant on small-scale 'mum and dad' investors, with the Australian Tax Office showing 72 per cent of property investors own one investment property and a further 19 per cent own two[2].

Of critical importance in addressing the current crisis is ensuring that current rental property owners are better supported to keep making their properties available to renters, and not be driven to change its use through onerous regulation or higher tax costs.

The Property Council of Australia acknowledges that the Victorian Government recently made significant reforms to the Residential Tenancies Act in 2018, with more than 130 changes made between 2019 and 2021 designed to provide further support and protections for renters. We want to ensure that an appropriate balance of regulatory frameworks that safeguards consumer rights while fostering an environment that is conducive to attracting investment, sustaining growth, and ensuring certainty for the many Victorians who rely on private investors to deliver supply to market. With the recent work on the Residential Tenancies Act, the Property Council feels that it is adequate and Victorian renters enjoy better, fairer and safer renting.

If we look to Queensland as a comparison, the Real Estate Institute of Queensland recently published the results of a survey of more than 3300 Queensland property investors, showing

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[1] 14_06_23_National_Vacancy_Rate_June_2023_Final.pdf (sqmresearch.com.au)

[2] Financial Review: Australia's most prolific property investors (are also the best paid); 9 August 2022

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more than 81 per cent of respondents said that state's recent and proposed tenancy law changes had influenced the likelihood that they would sell up[3].

Landlords highlighted that the onerous expectations that have been put on them, along with the rules that keep on changing, rising interest rates and maintenance costs, falling yields and a cap on rent rises (now changed from 6 monthly to yearly increases) have also made holding on to an investment property untenable for some. It is critical further policy reform in Victoria avoids such an outcome to deliver effective housing solutions.

The Property Council maintains that state governments should significantly increase housing supply, mainly apartments, purpose-built student accommodation and retirement living communities. They should boost supply across the housing spectrum including at-market, social and key worker housing to buy and to rent.

Detailed response

The factors leading to low availability and high costs of rental properties

Despite our famed quality of life and the promotion of a national lifestyle ideal, Australia is accidentally pursuing a low amenity and low liveability model of growth. According to Demographia's International Housing Affordability 2022 report, Australia was the sole nation with all its major city markets ranked as severely unaffordable[4].

There are several reports[5][6] that outline the current state of the market which clearly supports the proposition that more supply is the solution to rental affordability. The rental investment market is highly compromised and making it harder for investors to see a return and it must be acknowledged that rent caps or rent freezes will prove disastrous in the current climate.

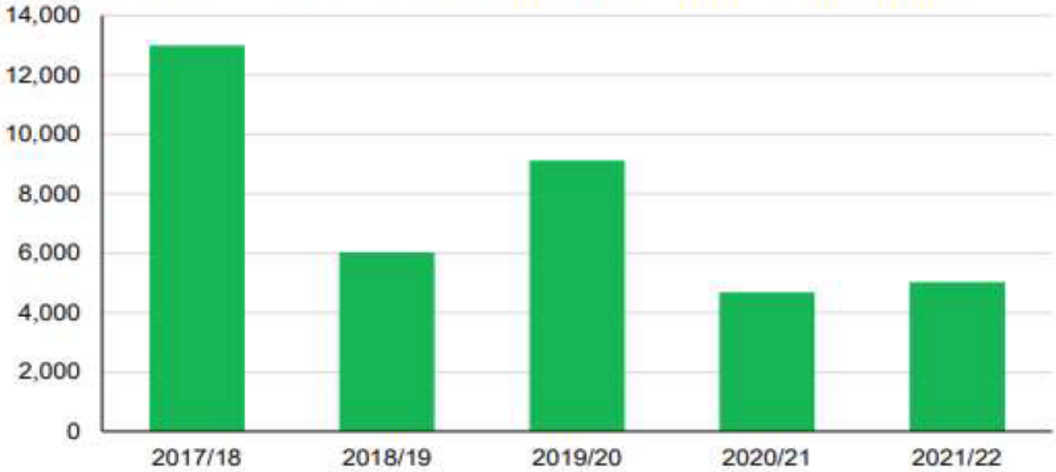
There are several common impediments to increasing housing supply including; costly zoning and drawn-out planning processes, and red tape imposed by the regulatory environment; combined with escalating construction costs and interest rates in the current environment. These issues are well understood by all industry participants.

The supply of apartments and townhouses directly influences rental costs and vacancy rates at the affordable end of the private market. The volume and value of annual building approvals for new lower-cost housing within Victoria's inner ring LGAs has been

[3] What property investors really think about owning in QLD | The Courier Mail
[4] A Stark Reality, Property Council of Australia, 2023
[5] Rent freezes and rent caps will only worsen, not solve Australia's rental crisis (theconversation.com)
[6] Housing supply shortfall to hit affordability and renters hard - building and construction news - API Magazine

assessed**.** If we look to the below graph, we see that volume of new residential building approvals; excluding standalone houses, has decreased from approximately 13,000 in 2017/18 to 5,000 in 2021/22. This represents an average reduction of 15 per cent per annum in supply of new low-cost housing[7].

Figure 5: Volume of New Residential Building Approvals (excluding Houses) in Inner Ring LGAs



Source: ABS and APP

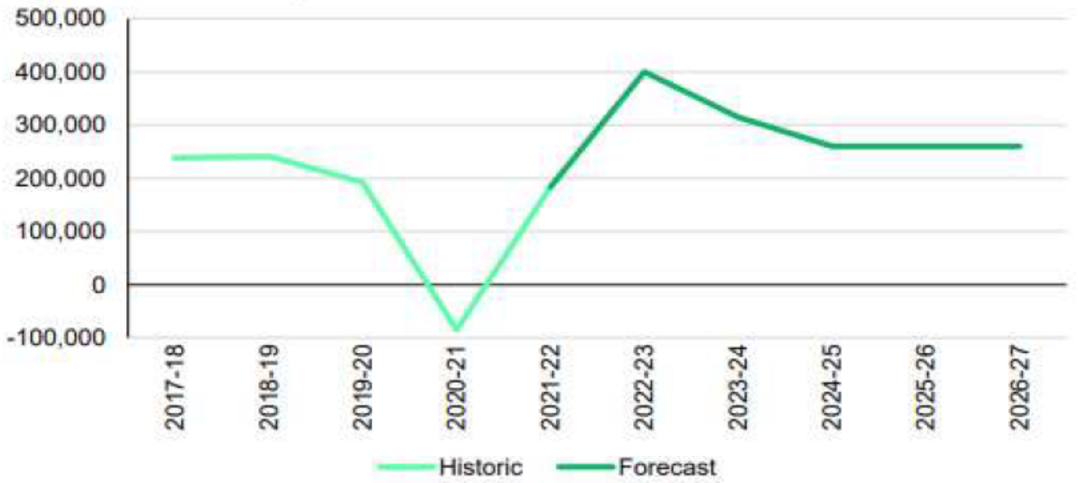
At the time of making this submission, we are in a perfect storm, with a significant reduction in the pipeline of new housing and home ownership, combined with population growth due to migration leading to further pressures in the rental market.

A report prepared by the Grattan Institute stated that "Housing inequality won't really fall until more housing is built[8]," and if we want to compare with a near neighbour; Auckland's large-scale re-zoning in 2016 saw an extra 5 per cent of the housing stock built in 5 years[9], indicating that governments can unlock supply if the right conditions are available to the industry[10].

While Victoria welcomes the increase of migrants after COVID-19 to fill crucial skill shortages and further add to the vibrancy of our state, this steep increase has resulted in further pressure on the rental market. Net overseas migration into Australia is expected to reach 400,000 in 2022-23 and Victoria generally accounts for 30 per cent of net overseas migration.

[7] APP Group | Investment in the Victorian Affordable Housing Market DRAFT, Commissioned by the Property Council of Australia, 2023
[8] Why the rich get richer - and how we can help renters and the young left behind (grattan.edu.au)
[9] Why the rich get richer - and how we can help renters and the young left behind (grattan.edu.au)
[10] New Planning Rules – Auckland Council Publishes Intensification Plans | News and Insights | Boffa Miskell

Figure 3: Net Overseas Migration into Australia



Source: ABS, DTF, and APP

Housing affordability is under pressure, even as median prices in capital city housing markets ease. The ability to borrow is decreasing and cost of mortgages are increasing, and rents are increasing too. This leaves supply as the primary lever to unlock housing that is affordable.

In the next 30 years, Melbourne will need to house an additional 3.4 million people. This means the city will need to deliver an additional 1.3 million homes, equating to an average of 43,600[11]* additional homes per annum. Geelong is also attracting major growth, with new growth fronts required to absorb incoming demand.

With the Minister for Planning recently reaffirming the refreshed Plan Melbourne will continue to target 70 per cent of new housing to be delivered through infill or apartment product, and 30 per cent in house and land/new communities, this would equate to 30,520 new infill or apartments dwellings and 13,080 in new greenfield areas dwellings each year.

However, challenges in the apartment market, constraints in the middle ring and impediments to land release in new communities are preventing supply from reaching the market. This is already making homes less affordable and risks deteriorating further[12]. The Victorian Government's looming housing and planning reform agenda will be critical for boosting not just overall supply volumes, but the diversity of housing types that will support affordability for both buyers and investors. As part of this reform, planning authorities should be required to adhere

[11] Greater Melbourne and Geelong – Residential Supply Research; Prepared by URBIS for the Property Council of Australia, 2022

[12] Greater Melbourne and Geelong – Residential Supply Research; Prepared by URBIS for the Property Council of Australia, 2022

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to the Plan Melbourne '70/30' strategic policy aspiration but not impair supply whilst reforms are underway.

Rent caps further impact renters

Rent caps affect renewals in current tenancies whereas on market listings can be advertised at any price (no cap). However, in a low vacancy/low supply market as we are currently experiencing, this may result in the landlord to opt to not to renew the lease and re-list their property at the end of that agreement.

This has impacts in that landlords realise market growth this way rather than renewals; they may incur an increase in costs for reletting/down time which may pressure rents further. Tenant lease security is reduced as turnover is likely to increase, as landlords are motivated to force tenants out to re-list at higher rates. If turnover increases, tenants then face higher costs associated with moving such as the cost of removalists and relocation, downtime from work and further stress on them.

Options to address insecurity, availability and affordability issues facing Victorian renters

To ensure that renters can readily access accommodation that is fit for purpose, there is a need to increase supply across key housing types that are targeted for need. There are a variety of typologies that are available to the renter and their needs, such as an apartment, villa unit, or house. Adding to this is a 'new class' of asset, a Build to Rent (BTR) apartment.

An introduction to Build to Rent (BTR)

The Property Council of Australia has been active in advocating for the BTR asset class.

BTR is purpose built and designed long-term residential rental accommodation which is predominantly owned, managed and operated by an institutional investor for a long-term investment period. Revenue is generated through the rental of the dwellings as the primary source of income, with additional income generated from opt-in and ancillary services.

BTR typically contains superior building amenity to foster a strong community within the building, including the use of event areas, co-working and co-living spaces and a pet friendly environment. Tenancy management services including repairs and maintenance requests are managed by on-site staff, and in many cases, no bond payments are required with tenure security provided through longer term occupancy. This all contributes to a far more positive leasing experience than what other rental property typically provide.

The Victorian Government's positive tax incentives announced in the 2020-21 Budget has established Melbourne as the nation's BTR capital to date, with 60 per cent of the country's BTR housing pipeline currently situated in Victoria. From 1 January 2022 until 31 December 2031,

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eligible build-to-rent developments receive a 50 per cent land tax concession for up to 30 years and a full exemption from Absentee Owner Surcharge over the same period.

Furthermore, BTR developments can be brought to market quickly, as the build-to-rent product does not require a minimum number of off-the-plan purchases to secure financing, allowing homes to be built quickly. This has been successful for BTR and has provided more diversity into the rental market.

The scope for further growth in BTR is strong, with an international comparison of the US showing us that it consists of 12 per cent of all housing stock[13].

As the BTR market evolves, with further diversity in offerings, it will continue to provide considerable opportunities in the market for renters to be able to secure a longer-term rental that is close to transport links and well situated, should policy settings continue to be supportive as they have been to date.

Rent caps and their impact on BTR

A significant threat to the growth of the BTR sector would be the imposition of rent caps. Rent caps would restrict the ability to offer additional and beneficial services by limiting the ability to generate sufficient rental income to support these services. The revenue generated from rent plays a crucial role in funding and sustaining resident amenities and services. With reduced or restricted rental income because of rent caps imposed while other costs are rising, operators would face financial constraints which would limit their capacity to offer such services or maintain the quality of existing amenities.

Increasing capitalisation rates, high construction costs and rising funding costs are currently posing challenges to the pipeline of BTR housing in Victoria. Our members have stated that introducing a rent cap in any state or territory of Australia will place a major hurdle in the assessment of and allocation of capital to BTR. Lenders and financial institutions often assess the financial viability of development projects based on projected rental income or net operating income (NOI). The imposition of rent caps or rent controls would affect the debt underwriting financial models and projections used to secure loans for BTR projects.

Reduced NOI because of rent caps would put pressure on a project's ability to generate sufficient cash flow to meet debt Interest Coverage Ratios (ICR) covenants and risk triggering a default event. Rental caps resulting in reduced NOI will also extend payback periods on BTR projects and potentially impact the ability to refinance or roll over existing debt as lenders become more cautious or unwilling to provide financing due to the increased risk associated with reduced rental income.

[13] A new form of housing supply for Australia: Build-to-rent housing report, prepared by EY for the Property Council of Australia, 4 April 2023

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Rent caps pose challenges for overseas investment into the sector. The returns would be below their hurdle rates leading to attracting less investment into BTR and therefore fewer sites being developed. A cap on rental growth will impact the risk/return assessment for BTR as an asset class and provide further impetus for capital to allocate away from BTR to other sectors putting further pressure on the rental market.

International comparisons clearly show that there are negative effects for rent caps or rent controls.

Average Dublin rents on new tenancies have increased 14 per cent over 2022, despite the 2 per cent cap. In New York, regulated stock has a significantly higher prevalence of maintenance issues than its unregulated stock. And if we look to San Francisco, a 2019 study found that rent controls in San Francisco reduced supply by 15 per cent, as owners converted rented stock into owner-occupied units or redeveloped existing stock to exempt them from rent control[14].

Government intervention should focus on the root cause of above average rental growth; being the lack of supply. The intent of policy and associated Government intervention should focus on increasing levels of supply – more supply will ensure market rents are attainable for the public over the long term.

Purpose built student accommodation

Purpose-built student accommodation (PBSA) is a welcome addition that addresses the housing shortage and provides solutions to both local and international students. PBSA curates living and learning environments for students while providing a sense of community. These living environments have stylish rooms and creative spaces and provide a sanctuary for students that nurtures and shapes minds. Residents have everything they need to feel safe, calm and at home while also feeling challenged, clued up and plugged in.

Adding to this bespoke living space for students and adding to the overall rental accommodation available, another benefit of PBSA is that it does not require student to seek accommodation in share houses.

Barriers to first home ownership and the impact this has on rental stock

We recognise that the Great Australian Dream is still alive and millennials that have chased it (in the absence of assistance from their parents or being high income earners) have had to leave the inner and middle rings and move to greenfield markets (typically in the growth areas) to purchase their detached home[15].

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[14] Rent controls: solution or setback? - CBRE Research, 2023

[15] Future opportunities for housing across Australia's Capital Cities; Charter Keck Cramer; 21 June 2023

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However, the inverse is that many millennials have traded-off dwelling type for location and occupied medium density dwellings (such as villa units, townhouses or terrace houses) or higher density dwellings (apartments or flats) in the locations that they have been delivered. The most recent 2021 ABS Census shows that a large percentage of millennials that have moved out of the family home, rent the dwelling in which they are living (53% in Sydney, 44% in Melbourne, 47% in Brisbane). The statistics further show that over the last 15 years (2006-2021), a much larger percentage are also now living in high rise apartments with 4+ levels (27% up from 12% in Sydney, 12% up from 3% in Melbourne, 9% up from 2% in Brisbane).

For many millennials, renting as well as living in either a townhouse or an apartment is a forced choice as they have simply been priced out of the housing markets across many of the capital cities (particularly Sydney and Melbourne). There are however a portion of the millennial population that do not wish to have a 30-year mortgage and are prepared to put their money into the share market and remain more transient. There is also a segment that are prepared to reside in apartments or townhouses longer term, particularly if they are well built and close to their sources of employment and amenity. Finally, a large segment of millennials are in fact from overseas and have brought with them their living preferences, which depending on their country of origin, is already for higher or medium density living. Consequently, a key focus of housing and planning policy should be to identify and drive the development of defined precincts with higher density housing options that are well located and connected to social and economic opportunities. This precinct development opportunity has been identified along key hubs that will be included in Stage 1 of the Suburban Rail Loop, with the Suburban Rail Loop Authority given specialist planning powers to deliver new higher density homes at scale. This would also add significant housing stock into the market and align with the 20-minute neighbourhood concept of everything you need being near to where you live.

At the same time, many first home buyers choose to buy a house and land package in the greenfields of Melbourne as this buyer gets a house and land package in a community of their choice. These house and land packages are often priced lower than a similar house in a built-up area. Now, with a more community focus given to developing these greenfields areas, the development encompasses housing, shopping centres, community centres and outdoor parkland for recreation. These choices also need to be supported through planning policy through the unlocking of new sites and the accelerated development of precinct structure plans.

Rent caps and impact on small investors

In Australia, a similar scenario would likely play out, particularly for the small private investor. The imposition of rent caps will likely result in many investors choosing to sell their properties or not invest in the Victorian market, resulting in fewer available rental properties for renters. Government cannot regulate all the input costs of holding property, eg repairs/maintenance, insurances, mortgage repayments etc, and therefore investors need to be able to adjust rents to ensure properties remain in market and well maintained.

Research by CBRE has shown in the UK that high levels of inflation increase the costs for landlords to maintain their properties. The 2021-22 English Housing Survey shows that the private rented sector tenure has the highest proportion of non-decent dwellings, with 23% failing to meet the Decent Homes Standard[16].

Any other related matters

The link between taxation policy and housing supply outcomes should also be explored by this committee. Please refer to our submission to the Economy and Infrastructure Committee's inquiry into land transfer duty fees, still underway at the time of this submission, for more information on the impact of taxation on housing outcomes,[17] noting that this doesn't take into consideration the Victorian Government's 'Covid debt levy' on land tax legislated in June 2023 and operable for the next 10 years.

Summary

The most comprehensive solutions to supporting rental and housing affordability are entirely supply-side, and we would encourage the committee to concentrate on recommendations that will facilitate both the volumes and the diversity of supply required.

The idea of adoption more punitive measures such as rent caps should always consider the impact on investment into the housing sector and the international evidence that shows the impact of caps has been at best limited and at worst downright contrary to its intention.

Put simply, the idea of rent capping as a solution to rental affordability has been thoroughly debunked and is a completely counterproductive policy option that will disincentivise investment and reduce the supply of rental accommodation – putting upwards pressure on rents.

[16] CBRE Research; March 2023; Rent Controls; Solution or Setback
[17] Inquiry into Land Transfer Duty Fees – Property Council Submission, 2023