Submission to the Inquiry into the worsening rental crisis in Australia

The interim National Housing Supply and Affordability Council (the Council) welcomes the opportunity to make a submission to the inquiry into the worsening rental crisis in Australia conducted by the Senate Standing Committees on Community Affairs.

The Council was established on 1 January 2023 to provide independent, evidence-based expert advice to Government on housing supply and affordability across the housing spectrum, including for the rental market. On 14 September 2023, both Houses of the Parliament passed the National Housing Supply and Affordability Council Bill 2023 that will permanently establish the Council.

Members of the Council are experts from across the housing sector, including on homelessness, social and affordable housing, planning, local government, industry and academia. The Council also engages with, and learns from, the diverse perspectives of stakeholders who are just as committed to achieving real reform in this space as we are.

The Council's task is to build the evidence base for national housing policy through its research, housing supply and demand forecasts, and by working to improve data availability and quality. This work will form the basis of the Council's annual report to the Minister on its research into housing supply and affordability.

The Council's submission to the Inquiry into the worsening rental crisis in Australia focuses on the recommendations set out in the Council's recent report into barriers to institutional investment, finance and innovation in housing. This submission does not provide detailed commentary on each of the matters described in the Senate Committee's Terms of Reference.

Recent work of the Council: Review into Barriers to Institutional Investment, Finance and Innovation in Housing

On 8 September 2023, the Council released its inaugural report, on barriers to institutional investment, finance and innovation in housing. The report was a result of work commissioned by the Minister for Housing, the Hon Julie Collins MP.

The report focussed on what can be done to increase the supply of secure homes in a rental format for more Australians, including in the affordable sector, via institutional investment.

As noted in the report, a vibrant institutional market for housing can add to the supply of rental stock and improve rental affordability. Institutional investors are an untapped resource for meeting Australia's rental housing challenge, providing secure homes in a rental format, improving environmental outcomes and raising quality in management while at the same time providing stable and attractive risk-adjusted returns for investors.

Many of the barriers to institutions investing in long-term residential rent stock are fundamentally related to the nascent state of the asset class.

The Council makes 11 recommendations in the report, which are reflected in this submission**.** These recommendations seek to ensure a pipeline of residential projects suitable for institutional investment, de-risk the development of large-scale housing assets, improve the provision of housing services, and support the expansion of social and affordable housing.

The recommendations focus on building a larger private rental sector and reinstating social and affordable housing as essential infrastructure for cohesive and productive communities.

The recommendations build upon the various Commonwealth and State level incentives which are already in place and are mutually reinforcing. They are proposed as a package in order that Australia can realistically meet the targets set under the National Housing Accord.

The Council suggests the following recommendations to reduce barriers to institutional investment, finance and innovation in rental housing specifically and to increase the supply of rental housing in general:

1. **Build-to-rent as a separately defined development type:** Commonwealth, state and territory governments should develop nationally consistent planning provisions under which large-scale build-to-rent projects are a separately defined development type subject to expedited planning and development assessment.
2. **Reviewing planning systems:** State and territory governments should identify, review and address barriers in planning and zoning systems that impede the construction of rental dwellings, including large-scale housing assets suitable for institutional investment.
3. **Improving land availability:** State and territory development corporations and their associated precinct planning bodies should accelerate land assembly (including through compulsory acquisition as a last resort), infrastructure provision and development approvals in areas which are suitable for the construction of rental dwellings, including large-scale intensive housing development.
4. **Establishing housing targets:** Commonwealth, state and territory governments should expand on the aspirational national target described in the National Housing Accord 2022 by agreeing to, and publishing, specific housing targets for each state and territory. Appropriate incentives and penalties should be attached to the meeting of these targets. This will ensure a pipeline of suitable housing assets exists to facilitate investor planning and to demonstrate policy commitment to the creation of sufficient rental dwellings and the development of an institutional housing market.
5. **Improving data availability:** Commonwealth, state and territory governments, and the community housing sector, should work with developers, institutional investors and other entities involved in the provision of rental dwells to identify and publish specific data that governments and the community sector are best placed to collect (or already collect) and make these data available to assist in de-risking the development and management of rental investments, including institutional housing assets.
6. **Appropriate superannuation regulations:** Superannuation regulations should be reviewed to ensure that they do not disincentivise investment in new asset classes, such as housing, while ensuring the integrity of the superannuation system.

7. **Gaps in financing:** Governments should address market gaps in the availability of long-term debt financing that limit institutional investment in market and affordable housing. Any provision of finance by government to support market housing should be on commercial terms. Measures should aim to close gaps in the provision of finance over time.

8. **A national regulatory framework for the community housing sector:** There should be a joint Commonwealth-state review to develop and implement a truly national regulatory framework for the community housing sector. The new framework should be designed to support engagement with institutional investors and address the increased complexity of funding arrangements in the sector.

9. **Supporting the community housing sector to partner with institutional investors:** Government support should be provided to the community housing sector, through its peak bodies or other such arrangements, to improve the ability of the sector to partner with institutional investors.

10. **Standardising definitions in the social and affordable housing sector:** Commonwealth, state and territory governments, with input from the community housing sector, should develop and adopt common definitions of matters related to social and affordable housing, including consistent definitions of 'affordable'. These definitions should be progressively applied to regulatory systems, planning schemes, funding agreements and government policies.

11. **Establishing a social and affordable housing asset aggregator:** The Commonwealth should support the establishment of an aggregator of social and affordable housing assets (or equity or subordinated debt), for example by subsidising the establishment costs and ongoing administrative costs of such a vehicle. Over time, the government should consider encouraging competition in the provision of aggregation services by supporting the establishment of new aggregators, including by the private sector.

The executive summary of the report is at Attachment A. The full report is available on the Council's website **www.nhsac.gov.au**.

Preliminary views on the rental market in the context of housing supply

All Australians deserve access to secure, well-located and affordable housing. We need a housing supply system that is more responsive to changes in demand and the needs of the community.

The Council considers that the supply of rental housing in Australia is well short of demand. Vacancy rates are around record lows, and national advertised rents continue to climb. Construction inflation and high interest rates are likely leading to a fall in new housing commencements, limiting supply of additional housing. This has contributed to adverse outcomes for renters, including increasing rental stress and higher rates of insecure housing and homelessness. It is not an exaggeration to say we are in a housing crisis. This crisis has been decades in the making and is a very complex problem to address.

Undoubtedly, a critical element to addressing Australia's access and affordability challenges is the supply of more housing, both for rent and owner occupied, that matches the growth and changing structure of the population. Involvement is required from all levels of government, the private sector and Community Housing Providers. Australia needs long-term solutions to solve a fundamental problem that we do not have enough quality homes that are both affordable and in well-located areas.

As discussed above, accessing institutional capital to invest in rental stock is one way to increase housing supply, which would improve affordability and ease rental shortages. Diversifying sources of rental supply through institutional capital will reduce over-reliance on individual landlords.

The Council is currently focused on identifying additional ways that supply can be increased and be more responsive to the needs of the community and the economy, as well as ways to facilitate housing affordability beyond increase of supply. This will be achieved through building and improving data and modelling for housing-related policy. This work is complex and will take some time, but is essential to inform evidence-based approaches to housing supply and affordability challenges.

The recommendations of the Interim Report of The Community Affairs References Committee

It is clear from the Community Affairs References Committee Interim Report, released on 21 September, and associated submissions that access to affordable, secure and fit-for-purpose rental housing is an issue experienced by renters across all states and territories in Australia. Australia needs a better private rental sector that is more responsive to the needs of the community. Social and affordable housing is essential infrastructure for fostering inclusive, diverse and productive communities, and decades of underinvestment in social and affordable housing has left the country with a significant shortfall. Funding the adequate provision of this infrastructure is a shared responsibility of all levels of government that requires better coordination.

The Council supports both recommendations made by the Committee in its Interim Report, that the Australian Government:

i. take a coordinating role to implement stronger rental rights; and
ii. continue investment in public, social, community and genuinely affordable housing.

The Council acknowledges the complexities of balancing the right level of reform. We look forward to the final report of the Inquiry, in particular the committee’s approach to boosting supply of and investment in rental housing. The Council will continue to build the evidence base for national housing policy and advise the Minister on national housing supply and affordability matters, including in the context of the housing rental market.

Attachment A

Executive Summary of the report into Barriers to Institutional Investment, Finance and Innovation in Housing

Australia's rental housing supply challenge

Australia deserves a housing system that promotes an inclusive, prosperous and sustainable nation. Essential to this is a well-functioning, well-supplied and responsive rental system that provides tenants with safe and secure accommodation, and access to employment and education opportunities and social services.

Such a rental system is also critical to economic prosperity. It improves labour mobility by providing more options for those seeking to relocate for employment, which supports productivity and economic participation. It also helps ensure people are able to live near their places of work.

Unfortunately, Australia is currently facing a significant rental housing supply and affordability challenge. Rental affordability has deteriorated, particularly since the COVID-19 pandemic. Finding rental accommodation is increasingly difficult; vacancy rates are at or near record lows in most cities and regions, the number of people who are experiencing homelessness is increasing, and the rate of insecure housing is growing (CoreLogic 2023b; Australian Bureau of Statistics (ABS) 2023a; Australian Institute of Health and Welfare (AIHW) 2023b).

Some of the stress in the rental system reflects cyclical factors, including the lingering effect of the pandemic on household preferences, employment arrangements and migration patterns. But there are also significant structural pressures underpinning increased demand for rental dwellings. The rising price of owner-occupied housing relative to income over the past 2 decades has constrained the ability of many households to purchase a dwelling or maintain home ownership. The long-term decline in household size has added to rental demand by contributing to household formation. The decline in social housing as a share of the total housing stock means that more lower income households require privately supplied rental accommodation than in the past (Productivity Commission 2022).

The rental market has been slow to respond to rising demand for rental housing. This in part reflects cyclical factors, including material and labour shortages. But it also reflects deeper structural constraints on the capacity of the rental market to quickly and cost effectively meet the housing needs of those who rely on rental accommodation.

The vast majority of rental housing in Australia is currently provided by individual landlords. Many landlords and tenants have respectful and mutually beneficial arrangements. But individual landlords may not always be well placed to respond to rising demand for rental housing. And the preferences, circumstances and needs of individual landlords and tenants may not always match, which can lead to sub-optimal rental experiences with respect to housing quality and tenure arrangements.

The role for institutional investment in increasing the supply of rental housing

There is a need for a major investment of capital to fund a significant increase in the quantity and diversity of Australia's stock of rental properties. As in the past, much of this capital will be provided by individual investors. Some will come from government through the creation of new social housing. Capital from institutional investors can also play a role.

Institutional investors are, broadly, entities through which investors collectively invest. They have large quantities of capital to deploy, invest for the long term, and spread their funds across a diverse range of investments.

Institutional investment in housing typically refers to equity finance invested by institutional investors in a collection of related dwellings to provide rental services at scale. It stands in contrast to the single dwelling provided by the individual landlord. It can also include direct debt financing of housing investment by institutional investors through bonds or other marketable instruments, rather than through banks or other traditional intermediaries. Implicit in the term is the existence of a wholesale secondary market for the exchange of housing assets between institutional investors.

More institutional investment in housing would benefit both investors and tenants. Institutional investors have a need for long-term assets with stable income streams. They manage significant volumes of capital, and so need markets capable of absorbing large capital flows. They also have a need for assets that are less correlated with other large, well-established asset classes.

For renters, more investment in housing by institutional investors could increase housing supply, which improves affordability and provides more housing choice for tenants. It also has the potential to drive innovation in areas such as housing design and construction, and improve the quality of the rental stock. It can drive efficiencies in areas such as energy consumption and housing maintenance. And it can create greater certainty of tenure by shielding renters from idiosyncratic factors that affect the supply of dwellings by individual investors. It also offers the potential of a more stable supply of housing, as the availability of institutional capital is less susceptible to the business and credit cycle.

Institutional investment in housing in Australia is very limited. Investment that does occur is primarily in niche sectors such as residential aged care facilities, student accommodation and subsidised affordable housing. Build-to-rent housing – which this report defines as apartment blocks or larger developments purpose-built for rental occupation and held in single ownership as a long-term revenue-generating asset (Pawson and others 2020) – is emerging as an asset class, but currently only accounts for 0.2 per cent of the total housing stock in Australia. In contrast, institutional investors have sizable allocations to Australian commercial, retail and industrial property.

Internationally, some economies have well-established or fast developing institutional housing markets (in which many Australian institutional investors participate). The United States (US) has the most mature market, supported by its large economy and advanced capital markets, long-standing system of subsidies for low-income housing and, in some jurisdictions, relatively accommodating development arrangements. In the United Kingdom

(UK), the sector is growing quickly, in part due to policy measures to foster institutional investment.

Key findings and recommendations: Australia needs a market for institutional housing

The central finding of this report is that the emergence of a domestic market for housing provided by institutional investors ('institutional housing') would add to, and improve the quality and diversity of, Australia's stock of private and not-for-profit (community) rental housing. A desirable market would have a well-supplied primary market (that is, a steady pipeline of large, multi-residential, well-located, unitary (i.e. single-owner) projects coming to market), and a secondary market (where established assets are traded) with low information asymmetries and moderate transaction costs. The development of new stock would be either by institutional investors themselves, or by large developers, with the stock acquired on completion as a single asset by institutional investors to provide for rental services.

To achieve such an outcome, the interim National Housing Supply and Affordability Council (the Council) has identified 3 categories of recommendations. These are: creating a larger pipeline of suitable projects coming to market; de-risking the development and ownership of institutional housing assets; and supporting institutional investment in social and affordable housing. Some of the recommendations address structural barriers to the formation of a market. Others aim to accelerate the formation of a market and support early movers. Some do both. The recommendations are best viewed holistically, rather than as a menu of options. This reflects the fact that they are mutually reinforcing, and that government and market participants need to address all barriers to support the emergence of a market. The recommendations complement and build on recent taxation measures taken by Commonwealth, state and territory governments to encourage institutional investment, including land tax concessions, a reduction in the managed investment trust withholding tax for foreigners, and an increase in depreciation rates (the efficacy of which should be reviewed in due course).

1. Creating a larger pipeline of suitable projects

A significant factor behind the lack of a market for institutional housing is an inadequate supply of new projects suitable for institutional investment. This limits the ability of the market to grow to the critical mass of assets and participants required to ensure a well-functioning and self-sustaining market. This shortage of supply reflects the scarcity of sites suitable for the construction of institutional housing assets, planning systems that limit development, and planning system complexity and inconsistencies that add to costs and risks associated with development.

Reflecting this finding, a central recommendation of the Council is that jurisdictions classify large-scale projects intended to be held as a single asset for rent as a discrete land use type for development assessment purposes, with the goal of creating a long-term, committed rental stock. In addition, the Council recommends reviewing planning and zoning systems and land availability to support more development of such assets.

2. De-risking the development and ownership of projects of institutional housing assets

A key view of the Council that underpins its recommendations is that the risks associated with developing and owning institutional housing assets are currently elevated due to the nascent state of the market. However, once developed, the return-risk characteristics of the market would be such that the market would be viable and self-sustaining. Until a market develops, investing in housing, and *investing in the capability to invest in housing*, is unattractive relative to alternative investment opportunities.

The lack of a market elevates risks in several ways. Too few projects limit the extent to which investment and underwriting analytics can be undertaken. Price discovery is limited, increasing the difficulty of valuing assets and raising risks for trustees who must ensure equity for members. Liquidity is limited, adding to disposal risk for owners and forcing potential buyers to purchase new assets, rather than source stock from a secondary market. It limits the extent to which providers of debt finance invest in their capacity to lend to the sector. And it elevates uncertainty about government policy and regulatory arrangements, given the lack of an existing constituency that can advocate for stability in policy settings.

The Council identified that some aspects of the superannuation system affect institutional investment in housing. These include the fact that performance test benchmarks have not generally incorporated housing. Several stakeholders also argued that some superannuation disclosure requirements create a perception that funds that invest in property have high management-expense ratios.

More generally, a common theme running throughout the consultation process was that the inconsistency in policy settings and frameworks between, and sometimes within, jurisdictions adds to costs and risks of individual projects. Moreover, the lack of policy consistency limits the ability of investors to derive benefits from scale by developing, holding and managing multiple projects.

To reduce risks for developers and investors, the Council recommends the establishment of housing targets and measures to improve data availability, which will improve certainty and the availability of information to facilitate the planning, and risk and cost management, of projects. The Council also recommends addressing gaps in the provision of finance. Finally, the Council advises a review of superannuation regulations to ensure they do not disincentivise investment in housing.

3. Supporting institutional investment in social and affordable housing

There are additional barriers to institutional investment in social and affordable housing. Regulatory regimes for community housing providers are inconsistent across jurisdictions and inadequately account for the complexity of financing arrangements. In addition, different definitions of affordable housing across (and within) jurisdictions add to complexity and administrative costs and stymie scalability of the sector. More generally, a high variance in the size and capabilities in the community housing sector limits the capacity of the sector to effectively partner with institutional capital. And it is difficult for investors to achieve scale in the sector. To address these, the Council makes recommendations related to community housing provider regulation, capability building, sector definitions, and the creation of an asset aggregator.

The fact that most rental housing in Australia is provided by private landlords via a market mechanism is taken as axiomatic, and this report does not provide an opinion on the merits or otherwise of a market-based housing system. Rather, in the context of Australia's housing market, it seeks to improve housing outcomes for a large and growing segment of the population. It does this by identifying shortcomings in the provision of rental housing that institutional capital is well placed to address and proposes recommendations that remove barriers to this outcome without favouring any one form of housing provision.

While beyond the scope of the terms of reference of this report, a concluding view of the Council derived from the international evidence is that a clear and nationally consistent regulatory framework of tenant and investor rights needs to be developed in parallel to the emergence of an institutional market to ensure both tenants and investors benefit from the market. The creation of such a framework need not be a barrier to institutional investment; rather, it can potentially provide additional certainty to investors, allowing better investment forecasts and risk assessment, while at the same time providing protections and certainty for tenants.