

# SUBMISSION

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## Long fixed-term residential tenancy agreements in New South Wales

January 2017

The Tenants Union of NSW (TUNSW) is pleased to provide this submission on long fixed-term tenancy agreements to Fair Trading NSW, at their invitation. Please contact Ned Cutcher, Senior Policy Officer, on (02) 8117 3712 if further discussion is required.

### Improving security of tenure in the private rental market

Improved security of tenure for residential tenants is a primary objective for the Tenants' Union of NSW. Limiting the circumstances in which landlords can end tenancies, rather than allowing them to initiate terminations without grounds, is the most effective way to deliver this. Tenants should have confidence that while their home remains available for rent, and as long as they continue to meet their obligations under the residential tenancy agreement, they should not be asked to relocate without a reason.

Following the statutory review of the *Residential Tenancies Act 2010* in 2016, Fair Trading NSW reported that security of tenure was a major theme in submissions from tenants and tenants' advocates. However, the review recommended no change should be made to the Act's provisions allowing landlords to terminate tenancies without grounds. Instead, it suggested "there are likely to be some tenants and landlords who are interested in long fixed term leases, and it may be possible for the Act to provide some incentives to make these more attractive".<sup>1</sup>

Reform to encourage long fixed-term residential tenancy agreements holds limited potential to improve security of tenure and stability for tenants. TUNSW's concerns about long fixed-term tenancies have been most recently set out in our submission to the

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<sup>1</sup> Fair Trading, *Residential Tenancies Act 2010 Statutory Review Report*, pages 23-24

statutory review of the Act.<sup>2</sup> To summarise these concerns: it is not the current regulatory environment provided by the *Residential Tenancies Act 2010* that prevents or discourages long fixed-term tenancy agreements, but the structure and composition of the NSW private rental market itself.

### Long fixed-terms: limited potential to improve security

The private rental market in Australia is predominantly made up of small holding landlords. A majority of landlords own only a single rental property,<sup>3</sup> and most operate at a loss. In 2013 – 2014, around 60 per cent of landlords reported negative net rental income on their properties – that is, they were negatively geared.<sup>4</sup> Despite their ongoing losses, these landlords are not primarily concerned with the supply of housing, but with returns on their investment. In general they adopt a speculative investment strategy, focused on capital gains rather than rental income. They use incentives within the tax system to offset their losses, while anticipating overall profits (boosted by further tax concessions or exemptions upon sale) as property is expected to increase in value over time.

The market for sale of rental properties is integrated with that for owner-occupation. In order to maximise capital gains, landlords like to offer vacant possession of property as it allows an uncomplicated sale to owner-occupiers as well as investors. In between sales, it is possible for landlords to eliminate future capital gains tax liabilities by moving into a property as their principal place of residence at least once every six years.<sup>5</sup> As such, landlords have a strong financial interest in rolling short fixed-term tenancies and/or periodic tenancies that can be terminated at any time without grounds.

### Thinking outside the box: why a fixed term at all?

Tenants have no such interest, but under the current regulatory scheme any perceived value in a fixed-term agreement at the commencement of a tenancy is understandable. No-grounds terminations are prevented, and rent increases are more tightly controlled during a fixed-term tenancy agreement than a periodic one. But if terminations without grounds were not allowed during a periodic tenancy, and tenants were better equipped to respond to proposed rent increases, tenants would be well served without fixed-term tenancy agreements at all. Variations on this approach are taken in Germany, The

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<sup>2</sup> Tenants' Union NSW, *Response to Fair Trading New South Wales discussion paper "Statutory Review of the Residential Tenancies Act 2010"*, January 2016, pages 15-16

<sup>3</sup> Australian Tax Office, *Interest in Rental Property*, available at <http://data.gov.au/dataset/ad-hoc-data-requests/resource/1be44656-d460-48c1-9d1a-49513c51e82a>, viewed January 2017

<sup>4</sup> Australian Tax Office, *Taxation Statistics 2013 - 2014*, Table 18

<sup>5</sup> See Australian Tax Office, *Treating a dwelling as your main residence after you move out*, available at <https://www.ato.gov.au/General/Capital-gains-tax/In-detail/Real-estate/Treating-a-dwelling-as-your-main-residence-after-you-move-out/>, viewed January 2017

Netherlands and Sweden, where indefinite tenancy agreements with strong rent regulation and protection against unreasonable eviction are the norm.<sup>6</sup>

A fixed-term tenancy agreement is not essential in New South Wales. It is possible to bypass fixed-terms and proceed directly to a periodic agreement at the commencement of a tenancy. In New South Wales, and in Australia generally, the majority of tenancies commence with a fixed-term of 12 months or less. There is no tradition of commencing tenancies with a periodic agreement, as tenants seek the assurance of at least a minimal period of predictability when establishing a new home – notwithstanding the Act's provision that applies a six-month fixed-term to oral residential tenancy agreements.<sup>7</sup> But there is also no tradition of tenancies on long fixed-terms.

This is despite allowances in the *Residential Tenancies Act 2010* for long fixed-term tenancy agreements. The Act already encourages long fixed-term tenancies by allowing some mandatory terms to be varied where agreements are fixed for a period of twenty years or more – for example a term may be added requiring tenants to assume responsibility for repairs and maintenance, or permitting tenants greater discretion regarding improvements to the property. This was an innovation in the 2010 Act – these provisions were not available in its predecessor. Even so TUNSW is not aware of a single long fixed-term tenancy of 20 years or more being established under the Act. It is apparent landlords do not wish to offer them, for reasons we have outlined above, while tenants would prefer greater security of tenure within a more flexible periodic tenancy. At the very least, long fixed-term tenancies that cannot accommodate an unexpected change in a tenant's circumstances or needs pose a significant financial risk for tenants. The likelihood that they would have to trade away rights in exchange for a long fixed-term tenancy agreement presents further unacceptable risk.

### **The answer lies in removing landlords' ability to end tenancies without grounds**

An effective way to address the insecurity of tenure that tenants currently experience is to remove landlords' ability to end tenancies without grounds, and provide an expanded list of 'reasonable grounds' for termination. The law should require landlords to be transparent as to their reasons for ending tenancies. This would allow landlords who have a genuine reason to end an agreement to do so, while giving tenants confidence that they may continue in their homes for as long as the terms of their tenancy agreement are met, and the property remains available for rent.

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<sup>6</sup> International Union of Tenants, *Rent regulation and security of tenure in the private rental sector*, October 2016, pages 7, 28-29, 36-37, 50-51

<sup>7</sup> *Residential Tenancies Act 2010* (NSW) s 14(3)

### Considerations arising from the statutory review of the Act

The NSW Government intends to explore possible changes to the *Residential Tenancies Act 2010* that would further encourage the use of long fixed-term tenancies. Fair Trading NSW is currently compiling options for further consultation. This follows a round-table discussion in late 2016, where key stakeholders, including the Tenants' Union of NSW, were invited to identify what incentives might be required to encourage the use of long fixed-term tenancy agreements, and the challenges that might need to be overcome.

In our contribution to this round-table discussion we noted that data from the Rental Bond Board shows the median period for which current bonds have been lodged in New South Wales is 21 months. Further, more than 40 per cent of currently lodged bonds have been held for two years or more, confirming that many tenancies already extend beyond the usual 6 or 12 month fixed-term agreement.<sup>8</sup> Standardising a minimum fixed-term of two or even three years for all residential tenancy agreements may be possible, as it appears this would meet the existing needs of a large number of landlords and tenants – notwithstanding landlords' interests in the status quo. We conceded, however, there would also be a significant number of tenants for whom a minimum fixed-term of two or three years would be impractical, and consideration would need to be given to the additional circumstances in which fixed-term tenancies could be brought to an end. Such consideration would also need to include matters of compensation payable when ending a tenancy during the fixed-term, to ensure that ending an agreement early would not become financially prohibitive for tenants, and that tenants could exercise reasonable choice when presented with changing needs.

We note this proposal would deliver a similar outcome to our preferred model of removing the apparent need for fixed-terms altogether by limiting the circumstances in which tenancies can be brought to an end. However, it would add rather than remove complexity, as it would require a number of new provisions to be inserted into the *Residential Tenancies Act 2010*. Even so, the potential for disagreements about the need to end an agreement during a fixed-term tenancy would be high. By comparison, indefinite tenancy agreements that require reasonable grounds for termination could be achieved with a few relatively simple legislative amendments.

Round-table participants representing landlords and real estate agents did not support long fixed-term tenancies as standard. They suggested landlords would not accept law reform to encourage the use of long fixed-term tenancy agreements unless such

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<sup>8</sup> Rental Bond Board, *NSW Rental Bonds as at 30 September 2016*, available at <http://data.nsw.gov.au/data/dataset/formal-gipa-access-application-2016-2017-fa-13>, viewed January 2017

agreements were optional. Additionally, they would require minimal loss of control over their investment property, and some form of financial incentive in order to make long fixed-term tenancy agreements attractive. Ideally, they would like the introduction of long fixed-term tenancies as a discrete product, allowing some terms that are mandatory under the *Residential Tenancies Act 2010* to be negotiable – or able to be contracted out of – where tenancy agreements are offered for a fixed-term of five years or more. To facilitate this, a standard form long fixed-term residential tenancy agreement could be included in the *Residential Tenancies Regulation 2010* setting out a number of optional terms for negotiation prior to establishing a fixed-term tenancy agreement of five years or longer. In pursuing such reform the circumstances under which a tenant could lawfully end a tenancy agreement during a long fixed-term without compensation to the landlord, and the amount of any break-fee payable where such circumstances are not present, would need to be established.

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We understand this model is being given particular consideration as an option for reform. We do not support it for two reasons. First, it moves the discussion away from any general concern about security of tenure, and creates a scheme where periods of secure tenure may be offered to prospective tenants at a premium. Tenants who are unable to find a landlord offering a long fixed-term tenancy, or who are unable or unwilling to meet the terms on offer, will remain subject to the insecurity of short fixed-terms and periodic tenancies that can be terminated without grounds. Second, it presents particular risks for low-income tenants at the less expensive end of the market, where choice is already limited by a household's means. Properties with high maintenance needs might be offered under long fixed-term tenancy agreements with reduced tenancy rights on a take-it-or-leave-it basis, and many tenants would have no option but to accept the terms on offer. Landlords might expect new tenants to take on repairs and maintenance obligations, which could be particularly onerous in properties in poor condition at the lower end of the private rental market.

It is also difficult to see how the majority of landlords and real estate agents would support such reform, in practice. Even with the current provisions allowing parties to contract out of certain obligations when entering into long fixed-term tenancy agreements, and the addition of a standard form long fixed-term tenancy agreement setting out the mandatory terms to which this might apply, only a relatively small number of landlords would be interested in offering long fixed-term tenancy agreements. Most, as speculative investors, will continue to place greater value on the ability to terminate a tenancy when it suits them so as to maximise their capital gains. But for the minority of landlords pursuing a different investment strategy, the prospect of a long fixed-term tenancy agreement that can be terminated by a tenant without compensation to the landlord, or with a break-fee set at a

level that would make such agreements attractive to tenants in the first place, is unlikely to offer much appeal. The likelihood is that only landlords seeking to let properties with high upkeep needs would find such agreements attractive, provided they were able to trade away repairs and maintenance obligations to reduce their holding costs.

### Issues and concerns

If the NSW Government is to pursue reform to encourage the use of long fixed-term tenancy agreements as outlined above, there are a number of risks and challenges that require further consideration. These apply to pre- and post-agreement matters as well as to any proposals for a standard form long fixed-term tenancy agreement. There is high potential for the majority of risks to be borne by tenants, who are already vulnerable to housing insecurity under the *Residential Tenancies Act 2010*. Finding appropriate ways to mitigate these risks will be critical.

### Pre-agreement

For pre-agreement matters, it must be understood that landlords generally offer tenancy agreements on a take-it-or-leave-it basis. Tenants are rarely in a position to shop around for a better agreement, whereas landlords are often presented with numerous applications – and therefore choice of tenant – when it comes to establishing a new tenancy. This puts tenants in a relatively poor position to negotiate the terms of a new residential tenancy agreement, and exposes them to potential risks where long fixed-term agreements may be on offer. What rights will they be required to trade away? How can they be sure of the state of the property? What additional costs must they bear? Will they be offered a short-term agreement if a long fixed-term agreement cannot be concluded?

TUNSW submits that the following conditions should be met in order for a landlord to offer a long fixed-term tenancy agreement:

- The offer should be accompanied by an alternative short-term tenancy agreement, allowing prospective tenants to make a clear comparison of the terms of each agreement. Where a proposed long fixed-term tenancy agreement seeks to contract out of the *Residential Tenancies Act 2010*, any risks and benefits of entering into the agreement should be highlighted. Tenants should retain the option to choose the short-term agreement where it is in their interests to do so.
- The offer should be accompanied by an invitation to seek independent advice as to the validity and reasonableness of any terms that contract out of the *Residential Tenancies Act 2010*. Fair Trading NSW should provide this advice and, where terms are both valid and reasonable, certify the agreement upon execution of the long fixed-term tenancy

agreement. Invalid and unreasonable terms of such agreements that are not certified should be voidable upon application to the NSW Civil and Administrative Tribunal.

- The offer should be accompanied by a building and pest inspection report for the property. The report should be less than five years old. Landlords should meet all necessary expenses for this report. The report should form part of the agreement if a long fixed-term tenancy is established, and a copy retained by the tenant.
- A cooling-off period of 90 days should apply, wherein the tenancy may be ended without penalty, or revert to a standard form residential tenancy agreement on a periodic basis. This should be at the tenant's discretion.
- Long fixed-term tenancy agreements that are established without meeting these conditions should be voidable at any time by the tenant, with 30 days written notice. Agreements that are void should either end without penalty, or revert to a standard form residential tenancy agreement on a periodic basis, at the tenant's discretion.

### Post-agreement

According to section 18 of the *Residential Tenancies Act 2010*, a fixed term agreement that continues after the day on which the fixed term ends continues to apply as if the term of the agreement were replaced by a periodic agreement, and on the same terms as immediately before the end of the fixed term. This raises two questions for long fixed-term tenancy agreements: should they be replaced by another fixed-term or a periodic agreement upon their expiry, and should they continue on the same or different terms?

TUNSW submits that, for simplicity, on the expiry of a long fixed-term tenancy agreement tenants should have the option of continuing under a periodic agreement on the same terms, but this should not be mandatory. It should be open to the parties to reach a new agreement on new terms if the tenant elects not to take up this option. Consideration will need to be given to how liabilities are determined at the conclusion of a tenancy in circumstances where terms of the agreement have changed over time. For clarity, it should be clear that all liabilities are determined according to the tenancy agreement and the *Residential Tenancies Act 2010*, and that the common law principle of "waste" does not apply.

### Standard form long fixed-term tenancy agreement

It is expected that a standard form long fixed-term tenancy agreement will include a number of optional provisions to be negotiated between the parties. However, as we have discussed, most agreements will be offered on a take-it-or-leave-it basis so it will be important to ensure non-negotiable terms are clear and well defined. Additionally, it will

be important to set some **minimum requirements that cannot be deviated from** when considering negotiable terms that may contract out of the *Residential Tenancies Act 2010*, such as responsibility for structural defects if repairs and maintenance obligations can be negotiated away.

The success of any long fixed-term tenancy agreement will be grounded in a respectful relationship between the tenant and landlord. In that light, any law reform to encourage the use of long fixed-term tenancy agreements should emphasise tenants' interests in making secure and comfortable homes. TUNSW submits the following for consideration:

- Landlords should not be able to contract out of their repairs and maintenance obligations in exchange for a long fixed-term tenancy agreement. In the event that they may, this should be limited to minor and cosmetic repairs and maintenance, and this should be clearly defined in the legislation. Landlords should retain all responsibility for the integrity of the property and any structures built upon it, including any capital improvements. Tenants should not be liable to the landlord, at any time, for any failure to carry out repairs and maintenance during the course of a tenancy that is established under a long fixed-term tenancy agreement.
- Rents should be set at the commencement of a long fixed-term tenancy agreement, and there should be no provision to increase the rent other than as provided in the agreement in dollars per week. While section 99 of the *Residential Tenancies Act 2010* makes it possible for a tenant to end a long fixed-term tenancy agreement on the grounds that the rent has been increased, unscrupulous landlords may use rent reviews and unreasonable rent increases as a way of forcing a tenant to end their agreement early. To avoid this, landlords should be required to consider their expectations when making an offer of a long fixed-term tenancy agreement, and factor them into the offer.
- Tenants should be entitled to make minor and cosmetic alterations to premises that are subject to long fixed-term tenancy agreements, without the landlord's consent. Where appropriate, tenants should employ the services of appropriately experienced or qualified contractors. Tenants should provide details of proposed minor alterations to the landlord and invite discussion as to quality and method, but landlords should have no right of veto. A landlord who believes a proposed alteration is unreasonable should be able seek Tribunal orders to amend or prohibit the alteration. Tenants should oversee repairs or provide appropriate compensation to the landlord where an alteration causes damage to property. Tenants should be entitled to recover the depreciated cost of any alteration at the conclusion of the tenancy. Disputes about



alterations to premises should be heard and determined by the NSW Civil and Administrative Tribunal.

- Landlords should not be permitted to access premises that are subject to a long fixed-term tenancy agreement more than once every 12 months, unless to carry out structural repairs, as invited by the tenant, or in an emergency.
- Tenants on long fixed-term tenancy agreements should be entitled to keep pets without disclosure to the landlord. All other relevant laws concerning animal welfare and the keeping of pets would need to be adhered to, but this should be of no consequence to a long fixed-term tenancy agreement.
- Tenants on long fixed-term tenancy agreements should be entitled to transfer or sub-let part of their tenancy without the landlord's consent. However, the landlord's consent should be required to transfer or sub-let the whole tenancy or premises to another person.
- Tenants should be entitled to end a long fixed-term tenancy agreement early, without compensation payable to the landlord, where this is warranted in the circumstances. In addition to the matters already provided by section 100 of the *Residential Tenancies Act 2010*, tenants should be able to end long fixed-term tenancy agreements upon discovery of a latent defect, and where a change in personal circumstances makes continuing in the tenancy impractical. Further consideration should be given to other grounds upon which a tenant might end a long fixed-term tenancy agreement early without penalty. Consideration should also be given to amending section 104 of the *Residential Tenancies Act 2010*, to remove the provision for the Tribunal to make compensation orders when terminating a fixed term agreement on hardship grounds. Further, the Tribunal should be empowered to end a tenancy on hardship grounds on consideration of the circumstances of the case, rather than the special circumstances of the case.
- Where a tenant ends a long fixed-term tenancy agreement early without grounds, a break-fee of no more than four weeks rent should apply. Four weeks rent should be adequate compensation for landlords faced with the unanticipated loss of a long fixed-term tenancy agreement, while ensuring that tenants will not be dissuaded from entering into such agreements where they are offered.

TUNSW looks forward to further discussion about law reform to improve security of tenure for tenants in New South Wales.