Kickstarting the productivity conversation: NSW Productivity Commission

TUNSW submission, November 2019

TENANTS' UNION OF NEW SOUTH WALES

The Tenants' Union of NSW (TUNSW) is the peak body representing the interests of tenants and other renters in New South Wales, including tenants in social housing. We are independent, secular and a registered charity. We are recognised as a key stakeholder by a number of government departments, particularly in relation to housing and renting.

We are a specialist Community Legal Centre with expertise in residential tenancy law and policy, and we are the main resourcing body for the state-wide network of Tenants' Advice and Advocacy Services (TAASs). Collectively the TAASs and TUNSW provide information, advice and advocacy to tens of thousands of renters across New South Wales each year.

We are pleased to make this contribution to the conversation initiated by the NSW Productivity Commission. We are chiefly interested in the experience of people who rent their home in NSW and how the productivity conversations impact upon them. We note that the federal Productivity Commission produced a report earlier in 2019 also examining the experiences of people who rent their home and making a number of recommendations. We are pleased that these issues are being considered.

Our comments and recommendations are limited to the questions which we answer here., being:

- What steps could the NSW Government take to reduce its reliance on transfer duty? (page 99 of the discussion paper)
- What steps could the NSW Government take to improve residential development regulations to support an adequate supply of affordable housing? (page 119 of the discussion paper)
- Should the NSW Government level the playing field in the housing sector by supporting a more stable source of housing supply? If so, how?
  and
  What is the most efficient mix of planning, regulatory and tax settings to deliver outcomes that get the balance right between tenure security and housing mobility? (page 121 of the discussion paper)

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What steps could the NSW Government take to reduce its reliance on transfer duty?

The Tenants' Union of NSW has long supported a move towards land tax as a tax collection tool that is more efficient one with minimal negative impacts, relative to other taxes, and significant positive impacts. We support an expansion of land taxes.

Advantages of land tax

As taxes go, a broad-based land tax has many advantages.
In principle, land tax is a **fair tax**, because:
• The value of land does not derive from the work of its owner. Instead, land values reflect the economic development of the community generally. It is fair to return a share of this value, through tax, to the community.
• Taxing the unearned rewards of land ownership means that the tax burden on work and enterprise can be reduced.
Land tax is an **efficient tax**, because:
• Land tax does not reduce the supply of land. It encourages productive land use.
• Land tax does not discourage dealings in land that are to the advantage of the parties (contrast transfer duty, which can discourage owners from transferring to more suitable housing and penalise frequent movers).
• Land tax is simple to administer and pay.

Land tax contributes to the affordability of land and housing, because it discourages speculative land holding. Instead, the land tax liability motivates owners to put land its best use, or sell it to someone else. In this way it also encourages the development of improvements to land, such as new housing, and allows greater rewards for work and enterprise – and so **contributes to economic growth**.

Land tax has practical advantages as a source of revenue for government, because **land tax cannot be evaded** (by its nature, land cannot be hidden or taken out of the jurisdiction) and is **less volatile** than transfer duty. This also means the cost of collection is reduced.

Problems with the present system

In principle, land tax is simple, fair and efficient, contributing to affordability and productivity. In practice, our present system is defective and does not realise all the advantages of land tax.

The present system is too narrow, because:
• **Owner-occupied housing is exempt from land tax.** The exemption of owner-occupied housing removes 60 per cent of the potential tax base, and encourages speculative holding of land for owner-occupied housing. Because land in other uses may be turned to owner-occupation, the exemption encourages speculative holding even where land tax presently applies.
• Other uses of land – **primary production, retirement villages and residential parks for retired persons** – are exempt, which similarly detracts from the advantages of land tax without delivering some other public policy benefit. Two exemptions – for price-controlled

boarding houses and cheaper inner-Sydney rental housing – do deliver a public policy benefit, because they are available only where the owner provides lower-cost housing. The exemptions for retirement villages and residential parks are not subject to such a requirement.

The present structure of land tax rates is also problematic:
• **The threshold is too high** – $692,000 is too high to be justified as an exemption for low-cost housing.
• Levying land tax on an owner's **total land values at an increasing marginal rate** discourages large institutions, such as superfunds, from owning residential rental properties. These institutions may otherwise be better able to offer long-term affordable tenancies, and more professional management, than are individual landlords operating on an amateur, speculative basis.

A reformed system of land tax

The Tenants' Union supports reforming land tax according to the following principles:
• **Broaden the base** – in particular, to include land used for owner-occupied housing.
• **Provide few exemptions, for well-defined public policy benefits.** The current exemptions for low-cost boarding houses and low-cost inner-Sydney rental properties should be retained. Other exemptions, if any, should be similarly narrow and well-defined.
• **Reform the rates structure**. This may be done in either of two ways. The threshold could be reduced and a single rate applied to the total value of properties owned. Alternatively, land tax could be levied on properties separately, at increasing marginal rates according to the value per square metre of the land. (This is the method recommended by the Henry Review.)
• **Replace other taxes** – in particular, transfer duty. Consideration should also be given to using land tax to reduce or replace taxes on work and enterprise. Land tax reform can be implemented equitably, by allowing owners who have recently paid transfer duty to credit those payments to their new land tax liabilities. Provision could also be made for low-income owners to avoid hardship by deferring their land tax liabilities to such time as their property is transferred.

Support for land tax reform

Reform for a broad-based land tax is supported by:
• The Australia's Future Tax System Review (**the Henry Review**) – which recommended a broad-based land tax levied at increasing marginal rates on land values per square metre.
• Research by the **Australian Housing and Urban Research Institute** (AHURI) – which modelled the impacts of the Henry Review land tax recommendations, and estimated that average lot values would decline by 5 per cent, and inner city values by 12 per cent.
• **Prosper Australia** – a non-government organisation inspired by economic justice and leading advocate for land tax reform. In particular, we recommend Dr Cameron Murray's report for Prosper on the initial implementation of moving from transfer duty to land tax in

the ACT[1].

Tenants and land tax

Land tax is payable by the owner of land. The *Residential Tenancies Act 2010* (NSW) provides that taxes payable on a rented property must be paid by the landlord (section 40). Landlords sometimes claim that they pass land tax onto tenants by charging higher rents. This is a dubious claim. Generally speaking, landlords charge what the market will bear. It is unlikely that landlords would charge any less than market rents if land tax were not levied.

It is also unlikely that market rents are pushed up by land tax. Because land tax is payable regardless of whether rental premises are let, the liability tends to encourage landlords to find a tenant and meet the market, and discourage them from holding out for a higher rent. (Contrast a sales tax, which is payable only when an item is sold, and so which permits holding out for a higher price, in effect passing that tax onto the buyer.)

It is true that during the period of a tenancy the operation of market forces may be inhibited by the large costs faced by tenants on moving out. As a result, a landlord may be able to increase the rent above the general market level. The *Residential Tenancies Act 2010* (NSW) provides that a tenant may take proceedings to challenge a rent increase because it is excessive, considering the general market level of rents and other factors (section 44). The Tenants' Union supports strengthening this provision, to provide that where the increase is greater than the increase in the Consumer Price Index Rents series for the relevant period, the landlord bears the onus of proving that the increase is not excessive.

[1] Murray, Cameron K & Prosper Australia (2016). *The first interval : evaluating ACT's land value tax transition*. North Melbourne, Vic. Prosper Australia

What steps could the NSW Government take to improve residential development regulations to support an adequate supply of affordable housing?

The NSW government should reconsider the Affordable Housing SEPP, which operates to allow various exemptions from planning controls for the purpose of affordability but has no mechanism to ensure affordability flows from the SEPP. We believe that the fact that affordability has failed to materialise has degraded the social licence of buildings created through the SEPP.

We recommend an increased role for government in ensuring NSW is meeting the housing need of its residents. It is apparent that while Sydney can generate a sufficiently large volume of building, it is not clear that this volume can be sustained. There remains a large question mark over whether the development industry will be able to continue building to the point that affordability concerns are genuinely eased.

A model that we would encourage further research to test for viability may be to implement targets for the supply of housing in three affordability bands (low income, moderate income and an 'open' band) across all areas of the Greater Sydney Region. These targets should be agnostic as to the delivery mechanism in the first instance. However, if an area is not on target, NSW government should enact counter-cyclical measures. These could include taking on a role as public developer, or implementing guaranteed state purchase of buildings (subject to pricing and quality control and compliance with other planning measures). In each area, the government driven supply should meet the affordability bands from lowest to highest first. This may create a neat balance between allowing the market to implement innovative solutions, whilst still ensuring that the basic public policy function of providing genuinely affordable housing to the people of NSW is protected.

Should the NSW Government level the playing field in the housing sector by supporting a more stable source of housing supply? If so, how?

What is the most efficient mix of planning, regulatory and tax settings to deliver outcomes that get the balance right between tenure security and housing mobility?

We examine this issue chiefly from the perspective of the tenant-landlord relationship, which may be expressed differently in different types of rental housing. The correct balance between tenure security and housing mobility is to ensure that a housing consumer (tenant) is free to change providers (landlord) when they perceive that there is economic opportunity for them to move, or when they can express their consumer choice to take up a better offer in the market. However, their tenure security needs to be protected because of the particular nature of the service being offered. This is best done by ensuring the provider cannot withdraw the housing service without transparency as to their decision-making.

We note the Discussion Paper includes a calculation from NSW Treasury concerning the direct costs to consumer, at $115million per year over 23,000 tenants formally required to vacate their homes. We also encourage consideration and further examination of the indirect costs.

We note that:

- 56% of NSW rental properties are in need of some repair[2], the highest proportion in Australia. As well as tenants living in poorly maintained homes with social costs attached, this means that NSW tradespeople are missing out on work. This requires further examination, but as a preliminary calculation if we assume a very small average of cost of $220 per item at least $100m worth of contracts are being missed. This alone could provide employment in the state for more than 1000 tradespeople.
- Tenants are more likely to have casual work on weekends with lost economic productivity associated with finding and moving homes as frequently as they do.
- Unaffordable and insecure housing is causing greater travel commutes resulting in reduced recreation time with associated health impacts; and reduced time to engage in community life with a range of flow-on impacts.

There are two fundamental errors that have been made in the approach to regulating the residential leasing sector for many years.

The first is that landlords, in their role as a service provider, have neither conceived of themselves, nor have been regulated as if, they are in business. A hairdresser must show they are a qualified hairdresser who either holds a trade qualification, or has been approved by a industry panel. The only barrier to entry for a landlord has been the price of the

[2]Choice, National Shelter and National Association of Tenants Organisations (2018) *Disrupted*: t*he consumer experience of renting in Australia*.

property.

In upcoming amendments to the Residential Tenancies Act, landlords will now promise to have read a brief landlord information statement. This is akin to requiring a hairdresser to watch a Youtube video – it does not guarantee they have understood the content, or are able to implement it. But while a bad haircut can be embarrassing, a poorly maintained, insecure home has serious ramifications for its consumer.

Regulators have assumed that the role of the real estate agent is to ameliorate this lack of business-like behaviour, in the same way that the owner of a company does not need to know how the machinery that their workers use actually operates – it is actually the employees who perform the role. The owner's role is merely to provide the capital. However this has not created a private rental sector which delivers on its role of providing stable, affordable and well-maintained homes.

This is largely because real estate agents are not empowered to perform the role expected of them by regulators. While agents have a professional statutory obligation to know the law, they cannot force their landlord to comply with that law, and risk their own business if they place too much pressure on their landlord. Further, roughly a third of landlords reported to the Census that they do not use a real estate agent to manage the property.

Second is that regulators have taken an approach that assumes that the two parties to a tenancy contract have come to that contract as equal parties. Upon inspection, this regulatory approach is clearly flawed – one party is approaching the contract as an investor seeking to maximise their return. The other is attempting to find a roof over their head. These are not complementary interests, to be treated as two sides of the same coin.

The proper conception of the interaction between housing consumer and housing provider is that it is the provision of an essential service. This fits in conceptions of housing being a basic need to be met, like food and fresh water. Unlike food, where supply is relatively abundant and mobile, housing is more similar to other essential services like energy and water which require significant immobile infrastructure to support their delivery. We do note that food, unlike housing, has enforced safety standards to prevent harm from coming to consumers. Like these other essential services, it should be seen as inappropriate to cut off a person's access to the essential service of housing where they are complying with the terms of their consumer contract.

Where ending the housing consumer's use of the premises is regarded as necessary for the reconfiguration of the housing provider's business model (such as converting use either from rental to owner-occupied or from residential to commercial use, or significant renovations) then it is appropriate for this to be done in a transparent way, and with recourse to arbitration to ensure that the person is being treated fairly.

However, this flexibility is undermined by the current practice of allowing unfair withdrawal of the housing service. This would ensure greater quality of service provision, by ensuring a more equal balancing of market participants incentives.

While build-to-rent developers are making claims regarding the different relationship created by the different business model, we find the claim not to be compelling without greater evidence.

The fundamental issue with the claim is that they propose to create a product for which there is great demand and limited supply. The main argument for greater security in this scenario is that the landlord will have greater incentive to avoid vacancy as it has a more significant impact on their revenue than it would for an investor whose main focus is on the capital gain.

We are concerned that its very nature as a more desirable housing form with limited supply militates against this and the incentive to move on a tenant who seeks to enforce their contract remains as the tenant remains easily replaceable. An efficiently run block could potentially be turned over with a day or less vacancy.

To give build-to-rent models their best chance of delivering on their promises, and as a reasonable exchange for any reduction in tax burdens, NSW should reasonably require both affordability and stability standards to be met alongside planning and design.

1. NSW government should move to remove no grounds evictions, and replace them with an expanded list of reasonable grounds that may include substantial renovation, or shifting from a rented accommodation to an owner-occupied. What is important is that the grounds should be aimed at situations where the property itself is no longer going to be available to function as a home for rent (for some significant time period).

2. NSW government should also seriously consider implementing a regulatory framework to ensure landlords are:
   viable, either by requiring proof of sufficient cash reserves for possible maintenance obligations, or through lodgment of a landlord bond (which, like the tenants' bond, would act to ensure they are able to uphold their obligations under the tenancy contract); and
   professional, by requiring education by a registered training organisation that ensures they are aware of their obligations under the Residential Tenancies Act 2010 and are able to perform those obligations.

3. If Recommendation 1 is not implemented, build-to-rent projects that receive incentives such as tax relief or relaxed planning rules, have clear standards for levels of affordability and stability. In relation to stability, by forgoing the use of no-grounds evictions, there are a number of mechanisms that could be activated, whether planning control, application for relief from land tax after evidence of compliance collected, or through legislative reform.