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Submission to the Senate Standing Committee
on Environment and Communications

***Inquiry into the Treasury Laws
Amendment (Improving the Energy
Efficiency of Rental Properties) Bill 2018***

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About the St Vincent de Paul Society

The St Vincent de Paul Society (the Society) is a respected lay Catholic charitable organisation operating in 149 countries around the world. Our work in Australia covers every state and territory, and is carried out by more than 58,000 members, volunteers, and employees. Our people are deeply committed to social assistance and social justice, and our mission is to provide help for those marginalised by structures of exclusion and injustice. Our programs assist millions of people each year, including people living with mental illness, people who are homeless and insecurely housed, migrants and refugees, women and children fleeing family violence, and people experiencing poverty. In addition to providing material aid and assistance to those experiencing cost of living pressures, we provide programs specifically targeting energy affordability, including practical advice and outreach to assist people to reduce their energy consumption and improve energy efficiency.

Introduction

Improving energy efficiency should be a key policy response to mitigate the effects of rising energy prices, yet it has been largely neglected in recent political debates about energy affordability and cost of living pressures. The burden of rising energy costs falls most heavily on low-income households. Disconnections have increased, the number of households experiencing measurable hardship has risen, and more households are rationing energy to the detriment of their health and wellbeing.

The effects of spiralling energy prices are further amplified by the poor energy efficiency of most low-income housing. Despite being the most vulnerable to energy price increases, those on low incomes tend to have the least capacity to improve the energy efficiency of their homes. They are more likely to rent and, unlike home owners, have little control over efficiency improvements, while landlords have little incentive to invest in upgrades because the benefits largely accrue to tenants. This is leading to a situation where tenants are spending too much on energy, landlords are spending too little on energy saving features and, without policy intervention, there is little hope of the situation being rectified.

Against this backdrop, the St Vincent de Paul Society National Council (the Society) welcomes the current inquiry into the *Treasury Laws Amendment (Improving the Energy Efficiency of Rental Properties) Bill 2018* (the Bill). Decisive action to improve the energy efficiency of low-income housing is imperative, and the introduction of this Bill provides an ideal opportunity to bring this issue to the fore and generate impetus for reform.

The Bill amends the *Income Tax Assessment Act 1997* to allow landlords to claim a tax offset of up to \$2000 per year for energy efficiency upgrades to rental properties leased at \$300 per week or less. According to the Explanatory Memorandum accompanying the Bill, this tax offset is designed to “provide an incentive for landlords to undertake energy efficiency upgrades of their rental properties”.¹

The Society supports the underlying intent of the Bill and acknowledges the disincentives created by current tax arrangements. However, the proposed measure is unlikely to result in significant improvements to the energy efficiency of low-cost private rental given the voluntary nature of the measure, the persistence of landlord disincentives and the limited scope of eligibility for the proposed tax offset. We also believe further consideration needs to be given to the potential for unintended consequences and adverse effects, such as increases in rental costs. If the benefits of the Bill are to be realised and the risks minimised, a range of complementary policy and regulatory measures would need to be in place at the state and territory level, including mandated minimum energy efficiency standards for rental properties. Ultimately, meaningful improvements in the energy efficiency of low-income housing will require a mix of measures, with better coordination and cooperation between different levels of government.

The need for action to improve the energy efficiency of low-income rental properties

Rising energy costs and energy affordability

The need for decisive policy and regulatory action to improve energy efficiency in low-income housing is clear and compelling. Across Australia, low-income tenants in the private rental market already face escalating housing costs and unprecedented rental stress. These households are overrepresented among those unable to pay their utility bills.^{2,3} Rising energy costs have rapidly outpaced income gains for low-income households, forcing many to make desperate trade-offs between heat, electricity and other basic necessities.^{4,5}

For those on low incomes, the consequences of spiralling energy bills are profound and far-reaching. Dwellings with poor energy efficiency performance tend to deliver poor comfort, health and social outcomes, especially for vulnerable groups such as infants and the elderly. Some ration their energy usage in ways that compromise their health and wellbeing, such as under-heating their homes during the winter months or forgoing air-conditioning during extreme heat.^{5,6} For those with chronic health problems, such as cardiovascular and respiratory conditions, exposure to temperature extremes can aggravate pre-existing conditions and increase mortality risks.^{7,8}

In addition to direct health effects, the cumulative social, emotional and financial effects of unaffordable energy are significant. Having reduced energy usage as far as possible, some low-income households incur debts or divert funds from other essentials, such as medical treatment, healthy meals, basic household repairs and transport.^{4,9} The ongoing threat of disconnection and the daily pressure of managing limited finances heightens anxiety and stress. As an empirical study of energy hardship among low-income households found:

The well-being, health and lifestyle of low-income Australian households are suffering from the cumulative effects of ever-increasing electricity bills over a sustained period of many years which has compounded the circumstances of these vulnerable households... As a result of cutting expenditure on essentials such as food and reallocating expenditure on other items to be able to pay energy bills, and making relatively severe changes in household practices to reduce the size of energy bills, these households are suffering physical discomfort, reduced physical and mental well-being, loneliness and social isolation, strains within household relationships, and distress about the social and emotional well-being of children.⁵

Poor energy efficiency of low-income rental

The effects of rising energy prices are compounded by the poor energy efficiency of low-income housing, particularly low-income rental. People on low incomes are more likely to rent, with around one in two (49 per cent) living in rental accommodation.^{*10} Those in private rental are also much less likely to reside in housing with insulation or other energy efficient features, and are more likely to use inefficient appliances that are cheap to buy but expensive to operate.¹¹ Compared to those living in owner-occupied homes, renters are twice as likely to live in a home lacking insulation.^{12,13} While one in five (20.2 per cent) owner-occupied homes have a solar hot water and/or electric system, only one in 27 (3.7 per cent) households renting in the private market have a solar-powered system. Rental properties are also less likely to have draught-proofed doors and windows; are more likely to have structural problems such as major cracks or windows out of plumb; and tend to have less efficient heating and cooling systems.¹⁴

*'Low-income' in this instance has been defined as the bottom quintile (20%) of household incomes.

Split incentives and barriers to energy efficiency upgrades

A key barrier to improving the energy efficiency of low-income rental is the ‘split incentive’ between landlords and tenants. On the one hand, tenants have little control over efficiency improvements such as insulation, as they lack the authority to install more efficient fixtures and often have short-term leases. On the other hand, there is little incentive for landlords to invest in upgrades because the benefits of lower energy bills accrue to tenants. This situation is exacerbated by current tax arrangements, which do not allow landlords to claim a tax deduction or depreciation for energy efficiency upgrades as these upgrades are regarded as capital improvements.

Further impediments arise from the upfront costs of upgrades and the lack of accessible, timely and trusted information about the energy performance of properties and efficiency options and costs.¹⁵ The time and resources required to investigate and understand different efficiency measures adds a further dimension to the split incentive problem. Landlords find it costly and time consuming to learn about efficiency measures and, compared to home-owners, are less likely to dedicate time to acquiring knowledge regarding the drawbacks, benefits, supply, financing and installation of upgrades.^{16,17,18} Real estate agents (who manage three-quarters of rental properties in Australia) have also been found to have low levels of knowledge about energy efficiency.^{19,20,21}

Potential risks and implications of the proposed tax offset

The proposed tax offset targets a neglected but important area of policy and the Society firmly supports its underlying intent. Without policy intervention, barriers such as the landlord-tenant split incentive will persist and perpetuate the energy inefficiency of low-income rental, entrenching disadvantage and compounding the disparities between rental and owner-occupied dwellings. However, while the Society endorses the objective of the Bill, we believe further consideration needs to be given to the extent to which it will achieve this objective, as well as the potential for unintended consequences.

Effects on rental affordability

A key concern with the proposed Bill is the risk that landlords will take advantage of the offset in order to increase the capital value of their property, using it to increase rental costs and enhance the sale price for their property, and thereby shrinking the availability of low-cost housing options.

For those on the lowest incomes, the lack of affordable housing is of paramount concern. Many of those we support struggle with housing affordability and those in private rental have little capacity to absorb any increases in rental costs. In our experience, people often compromise on heating and other living costs simply to access or retain housing they can afford. They put up with the cold or the extreme heat because it means they have shelter. The possibility of paying more in upfront rent for a more energy efficient property – even if this might mean lower utility bills – is problematic for low-income renters who are already juggling budgets simply to stay put in their current accommodation.

As observed in an Australian study of energy efficiency in private rental, those investing in low-cost housing do not believe tenants would be willing or able to sustain increases in rents:

Investors of low-cost housing observed that while they would be happy to pay for minor measures to improve the energy and water efficiency of their properties, they believed that low-income tenants were focused solely on affordability and as investors they could not expect to be able to charge higher rents to recoup these costs.²²

These findings were reiterated in another Australian study by Wrigley and Crawford, which found a central policy challenge for low-cost housing was that renters could not afford rent increases to cover the cost of energy efficiency improvements.²³

Although the private rental market has grown over recent decades, the supply of affordable private rental for lower-income households has steadily declined. While this decline is attributable to various factors, the design of housing tax concessions has been key in driving up housing costs. Generous housing tax concessions have distorted the housing market, fuelling speculative investment in pursuit of capital gains, and inflating house prices and rents. This has in turn skewed the rental market toward more high-value, high-rent stock, with low-cost low-rent properties dropping out of the market.

In this context, it is vital any additional tax offsets do not add to the distorting and inflationary effects that existing tax concessions have exerted on housing and rental prices. There are simply not enough low-rent dwellings available and, to compound the shortage, there has been no growth in social housing. Moreover, further erosion of the tax base is problematic if the benefits of additional tax breaks accrue largely to property-owners rather than low-income tenants.

In overseas jurisdictions, rental premiums for improved energy efficiency have been identified in various studies of the private rental market.^{24,25,26,27,28,29} However, it is difficult to extrapolate directly from such studies given the effects of energy efficiency are contingent on multiple contextual factors, including the specific characteristics of the local housing market, the design and mix of energy efficiency initiatives (e.g. whether energy efficiency upgrades are mandated or voluntary; the presence of energy rating and disclosure systems; etc.), and interactions with other policies affecting housing affordability and energy affordability.*

The potential for energy renovations and retrofits to lift rents and shrink the availability of affordable housing has been recognised in energy efficiency schemes in Europe. Some countries have introduced rent stabilisation mechanisms alongside energy efficiency initiatives.³¹ For example, the Netherlands 'points system' includes an energy label, plus a covenant on energy savings in the rental housing sector that provides for a total housing costs guarantee. The total housing costs guarantee ensures that savings made in energy costs via renovations are greater than the increase in rent due to the energy savings.³¹ Similarly, the Swedish system of 'gross rent' combines heating and hot water charges into the overall rent that tenants are charged, thus providing an incentive for landlord to make investments.³¹ The German rent law also requires that the costs of energy efficiency measures financed through public loans must not be passed on to rents.³¹

In relation to the proposed offset, measures to reduce the risk of rent inflation will ultimately require coordination between Federal and state and territory governments. If the tax offset is adopted, the Society recommends guarantees are legislated at the state and territory level to protect tenants against associated rental increases (bar nominal increases within the guidelines of residential tenancy legislation), thereby preventing low-cost rentals from being priced out of reach of low-income households once energy efficiency measures are implemented.

Alternatively, adopting **mandatory minimum standards** at the state and territory level would be a more effective option that is less likely to inflate rents or reduce the supply of low-cost rental. The

* There has been limited analysis of the association between energy efficiency and rental costs in the Australian private residential market. A recent study by Fuerst and Warren-Myers examined the effects on house and rental prices in the ACT and found a positive association between energy efficiency and house prices and rents.³⁰

uneven uptake of a voluntary scheme will enable upgraded properties to command a premium in rent as they will have a competitive advantage in an extremely tight rental market. A level playing field is more likely to be reached if all rental properties are required to achieve a mandated minimum standard, thereby reducing the likelihood of rental increases and rental disparities between properties with and without energy efficiency features.

Moreover, if mandatory minimum energy efficiency standards were enacted at a state and territory level, landlords could claim tax offsets for energy efficiency improvements in the same financial year. This is because spending required to make a property satisfy regulatory requirements falls into the repairs classification under Commonwealth tax law.

In summary, we recognise that developing policy to improve the energy efficiency of low-cost private rental, while simultaneously ensuring the ongoing supply of this type of accommodation, is a fundamental policy challenge. However, while it is difficult to predict the inflationary effects of the proposed tax offset on rents, we believe there are alternative (or complementary) policy measures that are more effective and less likely to reduce rental affordability.

The threshold for eligibility

The Bill proposes that the tax offset be made available to rental properties leased at \$300 per week or less. This low threshold for eligibility will limit the depth and breadth of the Bill's impact, excluding many low-income renters.

The Productivity Commission has reported that 41.2 per cent of private renters are in housing they cannot afford or are paying more than 30 per cent of their total income on rent.³² Yet the proposed offset will not benefit many of these renters, with very few rental properties available for under \$300 in capital cities. Those on low-incomes and living in high-value rental markets have little choice but to pay for exorbitant rental prices for energy inefficient properties, while at the same time enjoying lesser benefits in real terms from assistance payments such as Commonwealth Rent Assistance.

In addition, the \$300 threshold does not take into account the size of household, making the offset inaccessible for multiple-occupancy dwellings, including share-houses and properties housing low-income families. This is of particular concern given the detrimental effects of energy-related poverty for children in low-income households. According to a KPMG report on the rising costs of energy, the population segment facing the greatest difficulties meeting energy bills are large families on a low income, including single-parent households with several children.³³ Given the lack of affordable housing, the only viable option for many individuals and families on the lowest incomes is to combine rental costs with others in compound or share houses. These larger dwellings can be among the least energy efficient, yet they would be excluded from the proposed tax offset given the combined rental cost for a larger dwelling is likely to exceed the threshold, even if the individual's or family's share of the rent is below \$300.

A further issue relates to the administrative costs of implementing a tax offset with such a low threshold. The administration of a property tax-based incentive program can potentially be quite complex. It involves not only applying the tax offset in line with the specifications but also the prevention of fraud and compliance checks. With the threshold set so low, justifying the administrative costs may be difficult given the small number of households that would be eligible.

The size of the offset

While the maximum tax offset that can be claimed (\$2000) may facilitate simple energy efficiency measures, this amount may be insufficient to stimulate investment in upgrades delivering substantial energy savings. Research by Sustainability Victoria suggests that a package of the most cost-effective measures would cost about \$5500 per house.³⁴ Given the overall poor energy performance of rental housing and the significant structural issues that exist in much low-income rental, there are grounds for increasing the cap to enable more substantive upgrades in properties with the poorest energy performance. However, robust standards and compliance checks would need to be in place to ensure more costly upgrades are used appropriately and are directed toward measures with the greatest energy-saving potential.

Inappropriate use of offset

Although the Bill proposes criteria that must be met to qualify for the offset, there remains a risk it will be used to subsidise ineffective upgrades that do not optimise energy efficiency. Ideally, initiatives to improve energy efficiency should target the poorest performing housing stock and promote the use of products and upgrades that achieve the deepest and sustained efficiency gains, such as insulation, draught-proofing sealing, and replacing heating and cooling systems. However, even where landlords do take steps to improve the efficiency of their properties, they often prioritise visible or cosmetic measures that will improve asset value over less visible but potentially more effective measures that would deliver larger benefits to tenants and the wider economy.³⁵ This problem is exacerbated in voluntary schemes and in the absence of mandated energy efficiency standards. It is also compounded where there is a lack of clear and reliable information about the relative performance and cost-effectiveness of different product choices.

It is therefore critical that access to the offset is conditional on installing a prescribed set of energy efficiency measures that meet certain standards and criteria (e.g. efficacy in terms of improving energy efficiency, cost-effectiveness and durability of the benefit over time). This in turn needs to be accompanied by validation and compliance mechanisms to ensure upgrades and appliances meet mandated standards and provide a genuine improvement in energy efficiency.

We are concerned that, as the Bill is currently drafted, these issues have not been sufficiently addressed. Under the conditions set out in Section 381-10 of the Bill, energy efficient measures that are eligible for the offset consist of “improvements of a dwelling, including the replacement or installation of an appliance, that increases the dwelling’s energy efficiency.” Defining eligibility in such a loose way will not guarantee measures are appropriately targeted, allowing landlords to claim for upgrades or appliances that provide limited benefits in terms of energy efficiency. It also leaves the scheme open to rorts, such as upgrades with artificially inflated prices.

We note that the Bill specifies minimal conditions for certain measures (retrofitting windows, insulation and solar panels), and also requires that appliances have a minimum energy rating of 3 stars. However, we believe a 3-star rating is a low threshold and is not appropriate for certain categories of product where the accepted minimum standard is set at a higher rating (e.g. air conditioning). It is also likely such a low bar would result in ‘deadweight’ effects, rewarding landlords with a tax break for replacing broken appliances which were going to be replaced anyway. In addition, some appliances would be ineligible under the Bill as they do not receive an energy star

rating. This includes hot water systems, high-efficiency gas space heaters, solar pumps, and efficient lighting.

To ensure the offset is used in a way that optimises energy efficiency and meets safety and quality standards, we recommend that a set of criteria be developed by an expert panel. These criteria should in turn be periodically reviewed and updated to reflect changes to technology and energy rating systems. Further consideration also needs to be given to the validation and compliance mechanisms that would need to be in place to guard against misuse of the offset.

Evaluation

If the tax offset is adopted, we recommend that it is accompanied by a comprehensive monitoring and evaluation strategy to assess whether the offset is having the intended effects, and to ensure the initiative is not being misused. We note that one of the recommendations from the Low Income Energy Efficiency Program was that an “evaluation strategy should be part of the design of new programmes to ensure that data needed to measure programme impact are carefully considered and data collection requirements are clear from the time a programme is launched.”³⁶

Scale of uptake and scope of impact

As a voluntary measure, we believe there would be limited uptake of the proposed offset. Experience from state and territory schemes indicates that most landlords do not take advantage of voluntary efficiency programs, even when they are subsidised. For example, aggregate data from the NSW Home Power Savings Program showed only 10.2 per cent of private landlords gave permission for the installation of free efficient showerheads and draught strips for low-income renters participating in the program.³⁷ Similarly, renters were underrepresented in the Central Victorian Solar City program, comprising only two per cent of recipients of energy savings assistance.³⁸ Several pilot programs funded by the Low Income Energy Efficiency Program (LIEEP) were unable to induce uptake by landlords, despite efforts at engagement.^{39,40}

The voluntary nature of the offset means that it will not resolve the issue of split incentives. Even with the tax offset in place, landlords will not directly benefit from upgrades (unless they hike up rental costs) given the benefits of lower bills and better living conditions will accrue to tenants. High rents and low vacancy rates mean there is very little incentive for landlords to voluntarily improve rental properties at the low to middle end of the private rental market, and very little choice for low-income tenants to refuse substandard accommodation. Arguably, landlords might anticipate eventual benefits accruing from capital investment in energy efficiency measures in the form of an enhanced sale price. However, it is likely such benefits (and therefore the most advantageous investment) will occur in the middle to high end of the housing and rental market. The lower end of the market is the least likely to yield benefits to the landlord and therefore the least likely to attract voluntary investment in enhanced energy efficiency. Moreover, a voluntary approach does not overcome the non-monetary barriers identified above, including limited knowledge about energy efficiency and landlords’ reluctance to invest time into understanding and implementing energy upgrades.⁴¹

The need for mandatory standards and cooperation with state and territory governments

Ultimately, effective action to improve the energy efficiency of low-income housing requires an integrated whole-of-government approach. Financial incentives and subsidies are only one tool in what must be a comprehensive suite of measures to drive deeper energy efficiency in low-income housing. As Philippine de T'Serclaes notes, “capital availability is not the most important tool in overcoming energy efficiency’s financial barrier. Instead, the solution lies in carefully designed policy packages, and strong political will”.⁴²

An essential element in any effective package of policies is **mandatory minimum standards for rental properties**. This would ideally be combined with mandatory disclosure of the energy efficiency of a dwelling at the point of lease or sale.

The introduction of mandatory minimum standards by state and territory governments would ensure meaningful improvements, provide greater consistency and certainty to tenants and landlords alike, as well as overcoming key barriers such as split incentives, landlord inertia, and asymmetrical power relations between tenants and landlords. The Society believes that a phased-in standard that is promoted, monitored and enforceable is critical to stop substandard properties falling through the gaps, leaving tenants with homes that have poor energy performance. Moreover, mandated minimum standards would enable energy efficiency upgrades to receive a tax offset, without the need to amend Commonwealth tax law. This is because, under existing provisions in Commonwealth legislation, spending required to make a property satisfy regulatory requirements falls into the repairs classification and is therefore deemed tax deductible.

Although state and territory governments have responsibility for rental property standards, Commonwealth leadership is vital to coordinate and drive a nationally consistent approach. Accordingly, we recommend that Federal Government put mandatory energy efficiency standards for rental properties on the agenda at the next COAG meeting in December 2018.

Conclusion

In the low-income rental market, the persistence of highly inefficient housing can no longer be treated as a marginal problem. Australian governments can – and must – do better.

This Bill highlights a significant problem that, for too long, has been met with political inertia, piecemeal responses and policy neglect. Energy efficiency is but one of a range of factors shaping energy affordability, yet the ongoing failure to act on energy inefficiency in low-income rental is serving to entrench and widen disparities and deepen the hardships of those struggling to pay spiralling energy bills. Decisive and concerted action to improve the energy efficiency of low-income rental is not only essential to improve energy affordability, but also has a role to play in reducing Australia’s carbon emissions, improving public health outcomes, and increasing the resilience of low-income households to a changing climate.

We commend the introduction of this Bill and welcome the opportunity it has provided to place the issue of energy efficiency on the national policy agenda. However, while we support the intent of the proposed tax offset, this submission has highlighted some potential issues and unintended consequences that we believe warrant further consideration. Ultimately, we believe a comprehensive and coordinated approach, which includes mandated minimum standards, is required to achieve meaningful improvements in the energy efficiency of low-income housing.

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