Submission by RMIT University and University of Adelaide researchers

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

As a group of economists, geographers and engineers all interested in promoting energy efficient affordable housing we make the following comments on the draft bill, in four parts.

1. The need for regulation to address the problem.

The Bill is a commendable attempt to make a substantial beneficial impact on the lives, as well as the health, of many lower income Australians. Energy equity is a national concern. Greenhouse gas emissions reduction are not mentioned. While we support the equity dimensions, the Australian Government has also got obligations under the Kyoto Protocol, which should not be forgotten.

Though Australian housing is generally of a high quality, a sizeable portion of our national stock is estimated to be poor quality, and often highly energy inefficient. Importantly, poor quality stock is overwhelmingly concentrated in the rental sector. One recent estimate (Baker et al 2016) of the prevalence of poor quality housing in the rental sector suggests that more than 450,000 private renter households and almost 195,000 public renter households are living in housing classified as poor quality or even derelict. Alongside widespread poor housing quality in the rental sector, severe housing affordability problems in many parts of Australia are driving a rapidly rising fuel poverty crisis among Australian renter households.

Recent research conducted for the Victorian Council of Social Services indicates that 7 per cent of Victorian households (180,000 households) have persistent difficulties paying utility bills, and 2 per cent (45,000 households) have struggled to heat their homes over several years. Most have children, and renters are much more likely to be experiencing persistent energy hardship (VCOSS forthcoming, 2018). Energy inefficient homes substantially increase the lifetime costs of a family's housing (Moore 2014). However, despite most landlords being concerned with the quality of the homes they lease to tenants, they are often unaware that their homes are energy inefficient (Horne et al. 2016).

Rapidly rising energy costs over the past 10 years in Australia have increased the impacts of energy inefficient homes on households. Self-rationing or avoidance of heating use altogether is increasingly used to manage financial hardship and energy bills (Nicholls and Strengers 2017). Self-rationing of cooling in extreme heat is also a significant risk to the health and wellbeing of households with children and the elderly (Nicholls et al. 2017). Older people can have difficulties identifying their own needs and the risks of excessively cold or homes, as well as navigating a complex energy market (Willand & Horne 2018).

2. Technical comments on the proposed tools and dwelling interventions

There are two aspects to the actions targeted; energy efficiency assessment, and energy efficiency measures. Clarity is needed around the role of assessments and how their costs are included. Section 381-5 (1)c states that "each of the energy efficiency measures satisfies the conditions specified in section 381-15". In 381-10 four types of energy efficiency measures are listed: three types of home assessments and one is referring to the physical improvement of the building. The use of the conjunction "or" seems to denote that there is a choice. However, 381-15, which needs to be satisfied according to 381-5 (1)c, lists only retrofits and upgrades. Hence, assessments would not be rewarded. It should be articulated whether the aim is to reward assessments in conjunction with retrofits or retrofits alone.

Energy audits are welcome. They are diagnostic tools that provide a summary of the energy efficiency of dwellings. They may assess the material quality of the building, the efficiency of

heating, cooling, lighting and other home appliances and householder energy behaviours in isolation or combination. They may also offer recommendations on how energy may be saved. Energy audits are popular information policy tools as they may drive retrofits, but they do not necessarily lead to such. Hence, measures to encourage home energy assessments should be linked to evidenced physical improvements to the home. Hence, assessment costs should only be subsidised if proof of energy efficiency improvements is provided.

The Bill offers a choice of three energy assessment tools: a NatHERS accredited tool, NABERS or the Liveability Features Property Appraisal. These three tools differ in their scope of assessment, algorithms and nature and metrics of outcomes.
NatHERS has the advantage that it is available nationwide, focused on energy, applicable to detached houses, townhouses and apartments, and that the algorithms are robust. However, the rating only takes into consideration the thermal performance of the building envelope. The efficiencies of the space conditioning system and lighting or fuel choice are not considered. Hence, an upgrade of a heating, cooling or hot water system would not be reflected in the NatHERS star rating. In addition, the NatHERS rating does not make recommendations for improvements. Hence, it is not a useful tool for promoting effective energy efficiency improvements. Finally, the output metric of a NatHERS rating is the normalised energy demand for heating and cooling. It does not reflect energy costs, which seems to be the focus of this Bill, or greenhouse gas emission intensity. In any case, for quality assurance, we would recommend that the ratings should be certified, i.e. been done by a certified assessor.

NABERS is also a national building rating tool which is supported by the federal and all state governments. NABERS has a suite of tools, of which two apply to residential buildings and which differ in scope, data source and assessment process. NABERS Apartments facilitates the assessment and performance of apartment buildings in term of energy and water use of the common spaces – not of detached houses, townhouses or individual apartments. Hence, the tool is targeted at strata corporations, but it is of limited use to individual landlords. NABERS Apartment ratings are performed by accredited assessors, which provides some quality assurance.

However, NABERS also offers the NABERS Energy Explorer. It is a voluntary rating that is free of charge and can be performed by anyone with access to a household's gas and electricity data for the previous 12 months and the Internet. The assessment is done online. The sample report for the example of a hot water system presents the estimated energy use, annual consumption costs and greenhouse gas emissions, suggests 14 replacement options with estimated upfront costs, operational costs for the first year and greenhouse gas emissions as well as no-cost behavioural recommendations with estimated annual energy cost savings. The information on capital costs and cost savings can be used to calculate pay back periods. This tool could be used by tenants, or if tenants and landlords collaborated, to inform retrofit decisions without costs.

The third tool listed in the Bill is the Liveability Features Appraisal Checklist. It is a very new tool, whose suitability is difficult to assess at this stage. The tool is managed by The Centre for Liveability Real Estate, which is owned by the Commonwealth Scientific and Industrial Research Organisation (CSIRO). The Checklist contains 17 criteria and compares the dwelling against benchmarks to present a consistent national standard. Relevant criteria for the assessment of thermal performance of dwellings are the interplay of climate zone, orientation, cross ventilation, zoning, insulation, density of building materials, windows, shading or sun control, efficiency of lighting, heating, cooling and hot water systems, solar photovoltaic systems. The tool is currently being trialled in the ACT. Liveability Features Property Appraisal are offered by trained real estate agents free of charge. Details on the metrics of the Checklist and recommendations were not readily available online.

It may be worthwhile to consider the use of the Victorian Residential Energy Efficiency Score card. The Victorian REES assesses the efficiency of a home based on its simulated energy consumption costs. The assessment considers the thermal quality of the building envelope, heating and cooling appliances, hot water system, lighting and micro-generation. The home rating is on a scale from 0 (least energy efficient) to 10 (most energy efficient). It provides an assessment of the dwellings thermal performance in summer and offers recommendations on how the energy efficiency of the home may be improved. Hence, the rating provides information on costs and guidance on retrofits, which would be desirable to promote the uptake of energy efficiency improvements. The National Energy Productivity Plan provides for the expansion of the tool for climate zones beyond Victoria and its testing by all jurisdictions.

Interesting and commendable is the introduction of quality control in 381-15, namely the required accreditation of the installers of solar photovoltaic panels and insulation by the Clean Energy Council, and minimum performance standards, namely the suitability of windows to climate zones and a minimum 3 star appliance rating. This is likely to have been a lesson in risk management learnt from the insulation grant scheme. It highlights that safety and quality are (finally) being acknowledged by federal government processes around energy efficiency. However, the minimum appliance star rating should be reviewed and adjusted to the type of appliance. For example, Sustainability Victoria recommends a minimum of 4 stars when purchasing gas room heaters or gas ducted heating.

3. Problems with the proposed financing mechanism

Eroding the tax base and fuelling already generous tax concessions

The financial mechanism proposed is problematic. By international standards there are already generous tax concessions available to so called 'mum and dad' investors in rental housing. They are widely believed to be one important factor that has been pushing up house prices and rents to levels that are hitting the living standards of low income groups and increasingly middle income groups as well. They are also a source of potential instability in the housing market and beyond to the wider economy because they are an important cause of household indebtedness in Australia. To extend those tax concessions, as proposed in the Bill, would further erode the tax base and add "fuel to the fire'.

Adding to housing affordability problems in the private rental housing market

The Bill would fund housing upgrades, and this would increase the market value of dwellings. Hence, it would encourage gentrification. Having improved a property, a landlord is generally entitled to raise the rent, however, the measure would also lead to uneven rent increases. As it will increase the supply of energy efficient dwellings, and reduce the supply of energy inefficient dwellings (all else constant), if the level and pattern of demand remains unchanged these supply changes will make it less possible for landlords of energy efficient properties to raise rents; however, the lower supply of energy inefficient properties will put upward pressure on rents in this segment of the market. This may make the rent unaffordable for the existing tenants, which would be a perverse/ unintended outcome. The current Bill does not appear to anticipate this predictable outcome and provisions are needed to protect tenants from rent rises and protect the public purse from landlords benefitting from both tax concessions and also from higher rents following the works.

The 'affordable'/low cost sector of the rental market is widely documented to be fiercely competitive. If landlords 'double dip' by receiving a tax offset for improving the energy efficiency of the dwelling and then raising rent subsequently, tenants may be pushed out of affordable housing. From the work we have done, very low income tenants often trade-off the effects of living in energy inefficient housing, for the ability to access housing that they can afford. They put up with the cold because it means that they have housing. If energy

efficiency upgrades made by landlords mean that rents go up in energy inefficient housing too, tenants in this lowest quality stock will be worse off.

Uneven consequences spatially and across tenures

The focus of the Bill on properties leased at $300 or less each week aims to target assistance on low income people living in affordable rental housing. Although in total roughly 37 per cent of the Australian rental housing stock would be eligible, this proportion varies greatly between Australian states:

- New South Wales (30 per cent)
- Victoria (37 per cent)
- Queensland (36 per cent)
- South Australia (60 per cent)
- Western Australia (33 per cent)
- Tasmania (74 per cent)
- Northern Territory (42 per cent)
- Australian Capital Territory (26 per cent)

(Source: ABS Census 2016 data extract)

These estimates are conservative considering that rental increases since the 2016 Australian Census will have taken a number of properties over the $300 cutoff, and during the trial period for the Bill to 2022, it is assumed that a much smaller proportion of properties will be eligible. Also, across many Australian states, social renters are a key group that would benefit most from this Bill. It is unclear from my reading of the documentation that they would be beneficiaries of the Bill.

4. Proposed way forward

There is an urgent need to attend to retrofit of housing to reduce fuel poverty and also address climate change. However, the current Bill will exacerbate already existing housing affordability problems arising from tax concessions arrangements. Broadly, three options exist to address this:

1. Replace the tax concession propose mechanism with a standards approach, incorporating energy efficiency standards into the existing provisions for property and rent transactions. It would impose certain energy efficiency requirements. Modelling that has already been done suggests that the impact on rents would be very small and would not therefore impact housing affordability for low income groups. This is in part because some of the investments landlords would be obliged to make are capital in nature and can therefore be added to the cost base used to calculate assessable capital gains for tax purposes. Moreover, some of the cost of these energy saving amenities will be capitalised into the sale price that landlords obtain for their properties.

A standards approach should be accompanied by a government loans scheme that allows investors that are credit constrained to borrow with long repayment terms, that spread the cost over a number of years and therefore ensure that 'asset rich-income poor' landlords are not financially crippled by the requirements, but at the same time minimise the call on the 'public purse'. This standards approach would have the added benefit of setting a level playing field for property condition, applying to social landlords as well as private landlords (the existing proposal only applies to private landlords who are negatively geared).

There is the question of under which powers the Federal government would implement this reform. Perhaps the national government could do this by using its foreign affairs power using a treaty such as Kyoto, Paris etc. or alternatively pick up the threads of earlier COAG processes that were aimed at establishing a national system of disclosure of the energy efficiency of residential housing at the point of sale as currently practiced in the ACT. The

capacity to regulate the built environment only exists at the state government level and through the state governments local government.

2. If the tax concession arrangements as proposed were to be implemented, then regulation should require that if energy measures are subsidised, there is a certain obligation for landlords to guarantee future rents are kept affordable. The states through their landlord tenancy legislation is the only level of government that can regulate rents. New tenancy laws enacted in Victoria now limit landlords to one rent increase per year. The Federal government would need to collaborate with the states through COAG and make them responsible for regulating the rents for properties that had been improved using the new commonwealth tax provision. Also we can postulate that even if the national government did have the power to control rents because it was linked to a tax provision they would not have the administrative capacity to regulate observance. It would be similar to the pink batts episode and building regulation in that none of their agencies would have the staff or the knowledge of the rental market necessary to regulate rents.

3. If the tax concession arrangements as proposed were to be implemented, then regulation should ensure that the overall tax concession burden is not increased, by, for example, altering the bill to first reduce the total tax concession currently available to negatively geared landlords by $2000/yr. Then make the energy efficiency rebate available as a further $2000/yr concession only to landlords who install efficiency measures and meet the rent criteria. Thus negatively geared landlords would lose $2000/yr of their current tax concession. The minority in the low-cost sector of the market would retain the existing arrangement only if they improve efficiency. This is more complicated than the proposed bill but by reducing the aggregate level of concession would be revenue positive relative to current arrangements, as opposed to revenue negative. As it stands the current proposal will cost government $2k in revenue for every landlord who takes up the concession whereas it could be used to make negatively geared landlords work harder for their concession.

References

Baker, E., Lester, L. H., Bentley, R., & Beer, A. (2016). Poor housing quality: Prevalence and health effects. Journal of prevention & intervention in the community, 44(4), 219-232.

Horne R, Dalton T & Moloney S. (2016) Beyond the split incentive: Governing socio-technical relations in private rental housing retrofit, in Retrofitting Cities: Priorities, Governance and Experimentation (eds. Mike Hodson and Simon Marvin), Taylor and Francis: UK.

Moore T. (2014) Modelling the through-life costs and benefits of detached zero (net) energy housing in Melbourne, Australia, *Energy and Buildings*, 70: 463-471.

Moore T, Nicholls L, Strengers Y, Maller C & Horne R. (2017) Benefits and challenges of energy efficient social housing, *Energy Procedia*, 121: 300-307.

Nicholls L, McCann H, Strengers Y & Bosomworth K. (2017) Heatwaves, Homes & Health: Why households vulnerability to extreme heat is an electricity policy issue, Centre for Urban Research, RMIT University, http://cur.org.au/cms/wp-content/uploads/2017/11/heatwaves-homes-and-health-rmit_full-report.pdf

Nicholls L & Strengers Y. (2017) Rising Household Energy and Water Bills: Case Studies of Health, Wellbeing and Financial Impacts, prepared for Victorian Council of Social Service, Centre for Urban Research, RMIT University.

Victorian Council of Social Services (forthcoming 2018). Battling on: Persistent energy hardship in Victoria.

Willand N & Horne R. (2018) “They are grinding us into the ground” – The lived experience of energy (in)justice amongst low-income older households, *Applied Energy*, 226: 61-70.

Willand N, Ridley I & Maller C. (2015) Towards explaining the health impacts of residential energy efficiency interventions - A realist review. Part 1: Pathways, *Social Science & Medicine,*133: 191-201.

Professor Ralph Horne
Professor Gavin Wood
Professor Tony Dalton
Associate Professor Emma Baker
Dr Nicola Willand
Dr Trivess Moore
Dr Larissa Nicholls