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27 May 2024

Dear Ms Molyneux and Ms Slattery,

REGULATORY IMPACT STATEMENT FOR THE RESIDENTIAL TENANCIES AND RESIDENTIAL TENANCIES (ROOMING HOUSE STANDARDS) AMENDMENT (MINIMUM ENERGY EFFICIENCY AND SAFETY STANDARDS) REGULATIONS 2024

I would like to thank your staff at the Department of Energy, Environment and Climate Action and the Department of Government Services (the Departments) for working with the team at Better Regulation Victoria to prepare the Regulatory Impact Statement (RIS) for the Residential Tenancies and Residential Tenancies (Rooming House Standards) Amendment (Minimum Energy Efficiency and Safety Standards) Regulations 2024 (the proposed Regulations).

As you know, the Commissioner for Better Regulation is required to provide independent advice on the adequacy of the analysis provided in all RISs in Victoria. A RIS is deemed to be adequate when it contains analysis that is logical, draws on relevant evidence, is transparent about any assumptions made, and is proportionate to the proposal's expected effects. The RIS also needs to be clearly written so that it can be a suitable basis for public consultation.

I am pleased to advise that the final version of the RIS received by us on 27 May 2024 meets the adequacy requirements set out in the *Subordinate Legislation Act 1994*.

Background

The *Residential Tenancies Act 1997* (the Act) is the key piece of legislation governing rental properties and rooming houses in Victoria. In 2018, the Act was amended to allow the Government to set minimum standards for residential tenancies in regulations. Following amendments to the Act, regulatory amendments were made:

- The Residential Tenancies Regulations 2021 introduced several minimum standards for rental properties related to door locks, ventilation, electrical and gas safety, structural soundness, toilets, windows, lighting, and heating.
- The Residential Tenancies (Rooming House Standards) Regulations 2023 introduced minimum standards for rooming houses (defined as a building where four or more people can live in rented rooms) related to ventilation, structural soundness, blind cord safety, laundry facilities, kitchen facilities, and the frequency of electrical and gas safety checks.

Problems

In the RIS, the Departments cite data from national and Victorian research, including the Victorian Residential Efficiency Scorecard and market surveys by Newgate, to highlight that a significant share of Victoria's rental stock exhibits poor energy efficiency, contributing to higher costs for residents. Data from the Victorian Residential Efficiency Scorecard found that 85 per cent of assessed properties had the lowest possible thermal rating during hot weather, while 75 percent had low or very low thermal ratings during cold weather.

The Departments explain that the problems of poor thermal performance and inefficient appliances affect renters more than homeowners because of market failures that arise in the rental market. This includes split incentives between renters and rental providers (providers bear the upfront costs of upgrades but only receive some of the benefits) and information asymmetry (providers have more information about the thermal performance of their property than potential renters). The Departments explain that these problems result in several negative impacts, including:

- financial impacts on renters from inefficient (and more costly) appliances;
- health impacts on residents from inadequate heating or cooling, such as respiratory and cardiovascular problems (inadequate heating), and heatstroke and dehydration (inadequate cooling);
- impacts on renters' mental health, productivity and comfort levels from being unable to afford adequate heating and cooling; and
- environmental impacts from greater emissions caused by inefficient appliances.

The Departments note that compared to renters, rooming house residents are more likely to be vulnerable, low-income earners, experience complex health conditions and have fewer options for alternative accommodations than tenants in a rental property. The

Departments therefore consider it is important that rooming houses provide adequate living standards including thermal comfort.

The Departments also explain the safety risk of injury and fatalities posed by loose hanging blind cords. Between 2010 and 2020, blind cord-related incidents led to two lives lost and 26 presentations to Victorian emergency departments. A recent Coroner's report recommended mandating blind cord safety anchors in all rental properties across Victoria.

Options and Impact Analysis

The Departments analyse different options to impose minimum energy efficiency standards relating to:

- ceiling insulation, draught sealing, hot water systems, shower heads, heating and cooling and blind cord safety anchors in rental properties; and
- minimum heating standards for rooming houses.

The Departments assess options for all elements except for blind cord safety with a cost-benefit analysis (CBA). The Departments assess options for blind cord safety with a breakeven analysis given the difficulty with quantifying benefits of improved safety.

For each CBA, the Departments consider benefits realised arising from avoided energy costs, greenhouse gas emissions = reduced healthcare costs from air pollution and portable appliance costs, where applicable. The costs estimated include capital, material, labour and quote/administrative costs. For most elements, the Departments select the option with the highest net present value (NPV) as the preferred option. For the elements where the highest NPV option is not the preferred option, the Departments outline other factors that have influenced their decision.

Ceiling insulation in rental properties

For ceiling insulation in rental properties, the Departments analyse three options related to the minimum 'R-value'¹ of ceiling insulation required:

- Option 1: minimum R3.5 ceiling insulation;
- Option 2: minimum R4.0 ceiling insulation; and
- Option 3: minimum R5.0 ceiling insulation.

The Departments also analyse two sub-options to assess whether the minimum standard should apply only to properties with no ceiling insulation, or also to properties with low levels of ceiling insulation:

- Sub-option A: standard only applies to properties with no ceiling insulation; and
- Sub-option B: standard applies to properties with no or low levels of ceiling insulation (R1.5 or lower).

¹ The R-value of an insulation product is a measure of the product's thermal resistance, with a higher R value indicating greater resistance to heat transfer and a greater level of insulation.

In the RIS, the Departments explain that compliance with these options will be required when a new rental agreement commences.

The Departments identify Option 3A (R5.0 ceiling insulation, applying to properties with no insulation) as their preferred option. Option 3A has an estimated NPV of \$249 million and a benefit-cost ratio (BCR) of 3.45 (over a 26-year period). Option 3A has a slightly lower NPV compared to Option 1A and 2A (\$254 million and \$252 million respectively). However, the Departments explain that this option will likely bring existing rental homes in line with the 7 Star energy efficiency requirements for new homes built in Victoria, and that R5.0 insulation is the most commonly installed insulation type in new homes in Victoria.

Draught sealing in rental properties

For draught sealing in rental properties, the Departments analyse four options:

- Option 1 (basic): require weather sealing around the entire perimeter of all external doors;
- Option 2 (medium): Option 1 plus weather seals on wall vents, unreasonable general gaps and cracks sealed for external doors and window frames, construction joints and wall linings, skirting and floorboards and wall penetrations;
- Option 3 (high): Option 2 plus seals for gaps around windows and other general caulking (e.g., ceiling roses, skirting and floorboards, and unused heating and cooling vents); and
- Option 4 (comprehensive): requiring rectification of all leakages or draughts identified in a comprehensive professional assessment (e.g., blower door test).

In the RIS, the Departments explain that compliance with these options will be required when a new rental agreement commences. The Departments outline that rental properties with open flued gas appliances or flueless space heaters will be exempt from the minimum standards, as this may worsen ventilation and increase the risk of carbon monoxide poisoning. An exemption will also apply for draught sealing in a kitchen facility where a gas cooking appliance (without a rangehood) is present.

The Departments identify Option 2 as their preferred option as it has the highest NPV and BCR of \$105 million and 1.30 respectively (over a 13-year period), which is mostly driven by avoided energy costs to renters. While Option 3 is estimated to have greater total benefits than Option 2, labour and material costs are greater than Option 2.

Hot water systems in rental properties

For hot water systems in rental properties, the Departments analyse four options, each progressively prescribing higher levels of energy efficiency:

- Option 1 (highest running cost systems): replace the least efficient systems (bottom 25 percent). Under Option 1, only electric off-peak storage, solar electric, heat pump systems and any gas systems that replace existing gas systems are allowed;

- Option 2 (average running cost systems): replace lowest 50 percent of inefficient systems. Under Option 2, only solar electric and heat pump systems are compliant. Existing gas systems can also be replaced with solar gas or gas instantaneous and storage systems of 5 star or higher;
- Option 3 (low running cost systems): replace lowest 75% of inefficient systems. Under Option 3, only solar electric and heat pump systems are compliant. Existing gas systems can also be replaced with solar gas or gas instantaneous and storage systems of 6-star or higher; and
- Option 4 (electric only, low running cost systems): as per Option 3, but only solar electric and heat pump systems are allowed. Existing gas systems must be replaced with electric solar or heat pump systems at end of life.

In the RIS, the Departments explain that compliance with these options will be required at the end of the life of the existing appliance.

The Departments identify Option 4 as their preferred option as it has the highest NPV of \$570 million (over a 20-year period). While Option 4 has the highest net benefit of the options, which is primarily driven by avoided energy costs, the Departments note that it also has the lowest benefit-cost ratio (BCR) of 4.62 due to higher costs of compliant electric hot water systems.

Shower heads in rental properties

For shower heads in rental properties, the Departments analyse only one option, which is to increase the minimum shower head efficiency standard to a 4 Star Water Efficiency Labelling and Standards (WELS) rating (from 3 Star WELS standard). In the RIS, the Departments explain that compliance with this option will be required when a new rental agreement commences.

The Departments assess that the Option is preferred to the base case as it is estimated to lead to a net benefit of \$223 million (over a 21-year period). The Departments explain that the modelling only accounts for installation costs of more efficient shower heads and energy savings realised. It does not assess benefits from reduced water usage (e.g., reduced water bills). As such, the Departments consider that the modelling is conservative and likely understates the benefits of having more efficient shower heads.

Heating and cooling in rental properties

For heating and cooling in rental properties, the Departments analyse four options, under which heating and cooling must be installed in the main living area of the rental home:

- Option 1: maintain the current minimum 2 Star heating standard and introduce a minimum 2 Star cooling standard;
- Option 2: minimum 2 Star electric-only heating and cooling standard;
- Option 3: minimum 3 Star electric-only heating and cooling standard; and
- Option 4: minimum 2 Star electric-only heating and 3 Star cooling standard.

In the RIS, the Departments explain that compliance with the options for heating will be required at the end of the life of the existing appliance. If there is no existing cooling system, compliance with the options for cooling will be required when a new rental agreement commences. If there is an existing cooling system, compliance will be required at the end of the life of the existing system. Compliance will also be required in homes that have not been subject to a new rental agreement three years after the commencement of the regulations.

The Departments identify Option 4 as their preferred option. Option 4 has an estimated NPV of \$1.4 billion (over a 20-year period). The Departments explain that while Option 3 has a higher NPV (\$1.45 billion), insufficient supply of 3 Star heaters in Victoria may make Option 3 significantly more difficult to implement than Option 4.

The Departments note that there are lower efficiency requirements for central systems under the preferred option than for room heating to account for differences in how systems operate and the supply constraints involved in replacing existing central systems.

Heating in rooming houses

For heating in rooming houses, the Departments analyse two options:

- Option 1: introduce a minimum 2 Star, electric-only heating standard for each bedroom of a rooming house; and
- Option 2: introduce a minimum 3 star, electric-only heating standard for each bedroom of a rooming house.

In the RIS, the Departments explain that if there is no existing heating system, compliance with the options will be required from 30 October 2025. If there is an existing heating system, compliance will be required at the end of the life of the existing system. Due to supply chain and efficiency considerations, rooming houses with central heating systems will be required to meet a lower 1.5 Star equivalent standard under both options. Rooming houses with a central heating system that is 1.5 Star or better will not need to replace their existing system until it reaches the end of its life.

The Departments identify Option 1 as their preferred option. The Departments estimate Option 1 will deliver a net benefit of \$25 million (NPV) in the 20 years post-implementation. Option 1 has a marginally lower net benefit than Option 2 (\$26 million, NPV). But, as with heating and cooling in rental properties, the Departments have considered the limited supply of 3 Star heaters in selecting their preferred option.

Blind cord safety anchors in rental properties

For blind cord safety anchors in rental properties, the Departments analyse only one option, which is to require all window coverings (curtains and blinds) to have blind cord safety anchors installed. In the RIS, the Departments explain that compliance with the option will be required by 30 October 2025.

This option is analysed against the base case using a breakeven analysis, due to the difficulties in precisely estimating the policy's likely benefits (i.e., lives saved and injuries avoided). The Departments identify the Option as preferred over the base case. With the cost of mandating blind cord safety anchors estimated at \$38 million and the Value of a Statistical Life at \$12 million, the policy would need to save 3.15 lives in the 7 years post-implementation to 'break even.' The Departments note that Option 1 may prevent injuries as well as loss of life, so this option could result in a net benefit. The Departments further note that the cost of compliance per property is small.

Impacts on the rental stock and rental market:

In the RIS, the Departments note concerns regarding the burden of increasing minimum rental standards, and the impacts on the rental market. The Departments cite 2022 research by the Australian Housing and Urban Research Institute to explain that they do not expect these new minimum standards will lead to a significant long-term impact on rents or the rental stock. However, the Departments acknowledge that it is likely that at least some of the costs will be passed onto tenants, and that recent cost of living pressures and interest rate rises may limit the amount of cost increases that rental providers and rooming house operators can absorb.

The Departments explain that rental supply may contract in the short-term as providers undertake upgrades to comply with the new minimum standards. The Departments also explain that these impacts will be limited by varying when compliance with each standard is required, and as some of the preferred options account for potential implementation risks (e.g., supply chain issues).

Implementation and Evaluation

The Departments expect the proposed Regulations will commence operation on 30 October 2024, noting that the triggers for compliance will vary by standard as outlined above. The Departments note that Consumer Affairs Victoria (CAV) will provide information about the new standards through its website and call centre. CAV will also be responsible for ensuring compliance with the new standards using existing enforcement and compliance processes.

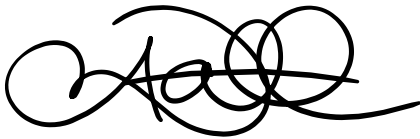
The Departments also outline exemption criteria for each of the proposed standards. Common exemption criteria across the standards include installation costs being significantly higher than in similar homes, upgrades conflicting with other Acts or requirements (e.g., the *Heritage Act 2017* or the rules of an owners' corporation covering the property) and when an appliance is being replaced under warranty.

In the RIS, the Departments outline an evaluation plan including ongoing, near-term and medium-term evaluation activities intended to monitor the effectiveness of the proposed Standards. The Departments explain that DGS, in coordination with CAV, will monitor the effectiveness of the proposed Regulations with reference to data on regulatory activity

and advice and will maintain an issue log based on stakeholder feedback. Near-term evaluation activities outlined in the RIS also include DEECA tracking the uptake of accreditation by installers related to the ceiling insulation standards. As the proposed minimum standards assessed in this RIS are high impact, the Departments commit to undertaking a mid-term evaluation drawing on data on contacts, investigations and Victorian Civil and Administrative Tribunal cases related to non-compliance with the minimum standards, as well as stakeholder input. The Department notes in the RIS that timing for the evaluation will be determined after the proposed Regulations have been implemented.

Should you wish to discuss any issues raised in this letter, please do not hesitate to contact my office on (03) 7005 9772.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'C Wall', with a stylized, cursive script.

Cressida Wall

Commissioner for Better Regulation