Defence Housing Australia Service Fee Comparison

> Detached Houses

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EXECUTIVE SUMMARY

Defence Housing Australia (DHA) provide quality housing and related services to Defence members and their families in support of the operational, recruitment and retention goals of the Department of Defence.

To meet Defence housing obligations, DHA is active in Australian residential housing markets, acquiring and developing land, and constructing and purchasing houses.

DHA sells properties it owns to investors under a leaseback arrangement (referred to in this document as sale and leaseback). It also leases properties direct from private landlords. These properties are then used to house Australian Defence Force (ADF) members and their families.

As part of its lease agreement, DHA is required to manage the property. The fee for managing a detached house is 16.5% (inc. GST)[1] of the gross rent. While this appears high in relation to quoted real estate agent management fees, in the range of 6.6% to 11% (inc. GST), the “all inclusive” nature of DHA’s fee includes a number of costs that would be borne by a landlord on top of the fee paid to a real estate agent under a traditional agreement.

Under a traditional real estate agent management agreement, there are many fees, charges, and costs in addition to the percentage charged to manage an investment property. The landlord is responsible for any necessary repairs and maintenance of the property in order to achieve market rent and, in order to achieve good capital growth, undertake other required maintenance (such as repainting, new floor coverings, etc.) through the life of the property.

Moreover, the landlord bears the cost of foregone rent if the property is vacant for a period of time, the cost of re-letting and finding a new tenant, costs of a delinquent tenant, the hassle of approving and dealing with issues as they arise, and the risk of a fall in rent below the commencement rent. DHA allows for all these costs, including most repairs and maintenance, in its lease agreement.

Table I below highlights the total costs that can be incurred with a traditional real estate agent’s management agreement to match the “all inclusive” management of a DHA leased property (detached house). This allows a direct comparison of the costs associated with the two management types. The table draws from the analysis in this report and considers three scenarios for rent achievable as well as a low, medium, and high cost scenario to allow for possible variations in costs. The medium scenario is around the mid-point of the range of costs identified, and is considered the most likely scenario.

Table I: Real estate vs. DHA property management fee costs for detached houses (per annum) – 9 year term (includes GST where applicable)

Weekly Rent	$300	$450	$600
DHA property management fee ($)	2,583	3,874	5,166
DHA property management fee (% of gross rent)	16.5	16.5	16.5
Low scenario			
Real estate fee plus additional costs ($)	4,026	4,730	5,659
Net gain of DHA lease ($)	**1,444**	**856**	**494**
Real estate fee plus additional costs (% of gross rent)	25.7	20.1	18.1
Medium scenario			
Real estate fee plus additional costs ($)	6,440	7,375	8,643
Net gain of DHA lease ($)	**3,857**	**3,500**	**3,477**
Real estate fee plus additional costs (% of gross rent)	41.1	31.4	27.6
High scenario			
Real estate fee plus additional costs ($)	8,811	9,918	11,468
Net gain of DHA lease ($)	**6,229**	**6,044**	**6,303**
Real estate fee plus additional costs (% of gross rent)	56.3	42.2	36.6

Source: BIS Shrapnel

[1] *For properties where a body corporate is responsible for some items DHA charge 13% (including GST).*

The cost of managing a comparable investment property (detached house) over a nine-year period (a common lease length with DHA properties) is typically lower under DHA’s fee than a traditional real estate agent’s fee. This is the case at three rent levels; $300, $450, and $600 per week and under each of the low, medium, and high cost scenarios. Even under the highest rent and lowest cost scenario, all costs associated with management totalled 18.1% of the gross rent (compared to 16.5% for a DHA lease agreement) representing a $494 saving per year.

The DHA fee also compares well with the costs associated with alternative investment vehicles, such as managed funds. Managed fund fees are expressed as a percentage of total assets under management, not as a percentage of gross revenue, which would be more comparable to the way management fees are expressed by a traditional real estate agent and DHA.

In conclusion, after taking into account all the comparable costs of managing an investment property to the same standard, the DHA fee of 16.5% provides savings over total costs borne by the landlord using a traditional real estate agent management agreement over a nine year holding period.

1 INTRODUCTION

This report compares the cost of Defence Housing Australia's (DHA's) "all inclusive" property management fee (referred to in its lease as *DHA Property Care*) versus the total costs of a traditional real estate agent's management agreement for detached houses. It also compares this cost with the cost of management of other managed investments.

DHA manages around 18,500 properties in Australia (of which just over 12,800 are leased) in order to house ADF members and their family. DHA's leased properties are managed by DHA, for which it charges an all-inclusive fee of 16.5% (inc. GST) of the gross rent (applicable to detached houses). At first glance, the fee appears higher than the headline fees offered by traditional residential managing agents (typically 6.6%–11% inc. GST). However, they do not provide the same level of management.

DHA's fee is "all inclusive", covering a number of typical costs and expenses which are borne by the landlord in a traditional real estate agent's management agreement. These include:

- repairs and maintenance
- painting and floor covering replacement
- rent lost during periods of vacancy
- rental floor (advantage of no decreases in rent from the initial rent during the lease term for DHA sale and leaseback products only)
- administration and re-letting fees
- tenant protection insurance, or alternatively, the possibility of a delinquent tenant; and
- hassle (quantifying the cost of the time required by a typical landlord to address repairs and maintenance and other issues).

As a result, the management fee charged by a real estate agent is not directly comparable to the "all inclusive" fee offered by DHA. Similarly, the fee charged for other managed investments (percentage of assets under management) and the DHA fee (percentage of gross rental income) are not directly comparable.

This analysis considers all the costs associated with traditionally managed residential investments to place them on par with the costs accounted for by the DHA fee in order to enable potential investors to make a better "like-for-like" comparison across alternative investments. The second component of this report converts the DHA fee to a fee as a percentage of the asset value to enable a better comparison with the management fees for an alternative investment such as managed funds.

As typical annual costs to a landlord can vary from year-to-year and from property-to-property, this report provides three cost scenarios for three indicative rental levels of an investment property (detached house). The medium scenario represents the middle, or indicative cost, while the high and low scenarios represent the upper and lower ranges.

2 COMPARISON WITH COSTS ASSOCIATED WITH A TRADITIONAL REAL ESTATE AGENT MANAGEMENT AGREEMENT

This section examines the additional costs borne by a landlord that are incorporated into a DHA lease agreement (i.e. but not covered by a real estate management agreement).

Real estate agent's management fee

Traditional real estate management fees can potentially vary from location to location, as can the cost and inclusion of various administrative fees. Real estate institutes, who are the professional association for real estate agents, rarely provide advice to agents regarding their residential management fees, and therefore there is no standard recommended fee. Rather, real estate institutes provide ethical guidelines and advice as to the current legislation influencing the industry.

In order to ascertain an indicative real estate agent management fee cost structure and any other associated costs, BIS Shrapnel contacted a sample of 18 local real estate agents spread across the locations in which DHA has concentrations of leased properties. The fees were indicated as a percentage of the gross rent received and were in a range from 6.6% to 11% (rounded). The management fees (as a percentage of gross rent) for the locations covered are indicated in **Table 2.1.** Prices are quoted either inclusive or exclusive of GST and we have adjusted all fees to include GST.

Additional fees included letting fees, which is largely expressed as between 1 to 2 weeks gross rent plus GST, and administration fees, which were found to range from $2.50 to $8.80 per month. This administration fee is for the preparation and provision of a monthly statement. In addition, a number of other fees are often charged over and above these fees and include advertising, database fees, preparation of lease fees, tenancy tribunal fees (if required) and others.

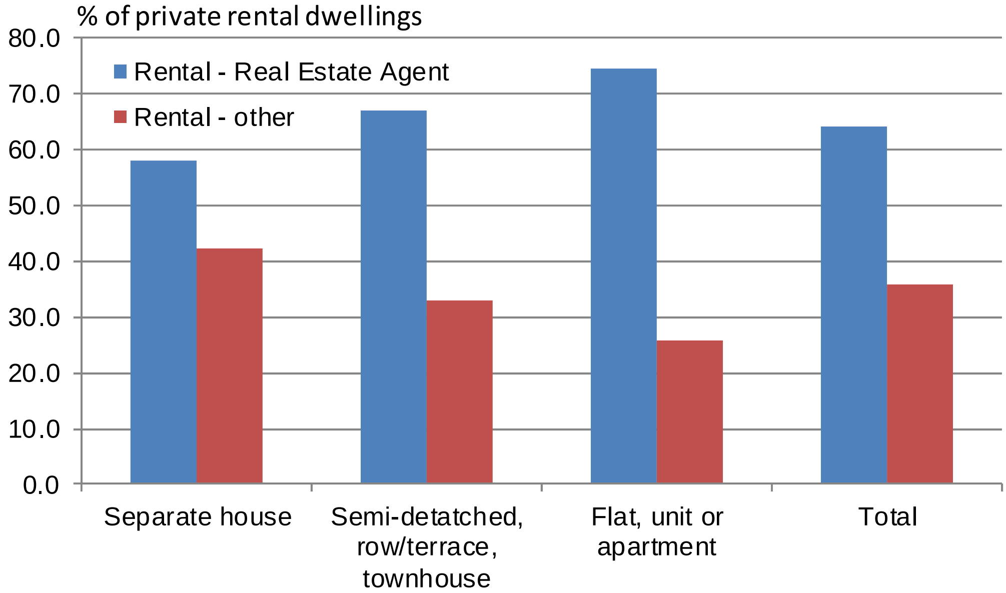
Table 2.1: Indicative real estate agent management fees (including GST) (percentage of gross rent)

Agent location	Indicative management fee
Capital city	
Sydney	6.6%
Melbourne	6.6%
Brisbane	7.7%
Adelaide	8.8%
Perth	9.3%
Canberra	11.0%
Darwin	9.9%
Regional	
Ipswich	8.5%
Toowoomba	8.8%
Townsville	9.9%
Wagga Wagga	7.7%
Hunter	8.8%

Source: BIS Shrapnel

While there is the alternative for a landlord to self-manage the property, the majority of landlords use a real estate agent. Analysis of the 2011 Census indicates that 64% of privately rented properties were managed by a real estate agent, varying from 58% of separate houses, to 67% for semi-detached, row and terrace houses, and up to 74% of all flats units and apartments (indicated in **Chart 2.1**). As a result, the analysis in this report is based on a comparison only with the costs of those who manage their property using a real estate agent.

Chart 2.1: Property type by rental management, Census 2011



**Average of five major states*
Source: Australian Bureau of Statistics, BIS Shrapnel

This report takes a bottom-up approach, whereby we break down the value that the DHA model provides to highlight the costs that a typical landlord would pay over and above a traditional agent's management fee, and which are absorbed by DHA.

Rent

The gross rent achieved by a typical rental property can vary significantly due to the quality of fixtures and fittings, number of bedrooms/bathrooms, overall size and location. An analysis of all the detached houses that have been sold and leased back by DHA between July 2013 and September 2014 (just over 900 properties) revealed that the properties largely clustered within three distinct rent bands:

- $280-$380 per week,
- $380-$500 per week,
- $500 and above.

Therefore, we have used rent of $300, $450, and $600 per week in each of our low, medium, and high cost profile scenarios.

Repairs and maintenance

Under a traditional real estate management agreement landlords are responsible for any repairs to their detached houses while tenanted and are likely to undertake further repairs and maintenance during or in-between tenancies, in order to keep their property competitive in the marketplace. DHA incorporates these costs into its management fee.

DHA has comprehensive data of actual expenditure on repairs and maintenance for their properties and at different rental price points. We have analysed this data to determine average costs and the magnitude of any potential variations. The data is based on expenditure for the 2013–14 financial year.

While DHA‘s property repair and maintenance costs apply to its properties only, there is no reason why these would differ substantially from a traditional residential rental, assuming that the landlord would keep his/her property well maintained. Given the extensive number of properties under management, DHA’s sample should provide a strong indicative cost of maintaining and repairing properties within Australia.

For the purposes of allocating DHA properties, the Department of Defence classifies them into five “rent bands”. The defence member rank then determines their rent band entitlement. The repairs and maintenance costs show little difference between properties in the first and second rent bands, which best corresponds with our $300 per week and $450 per week rental scenarios. The higher rent bands have different repair and maintenance costs due to the quality of fixtures and fittings, number of bedrooms/bathrooms, and overall size of the dwellings being managed. We have taken the costs of repairs and maintenance of these higher spec properties as indicative of those at the higher $600 a week rent level.

Given the variation in the repairs and maintenance cost per property due to location as well as due to rental cost, we have therefore provided three cost scenarios for repairs and maintenance costs based on the standard deviation from the average across all 16 major regions that DHA leases properties. These are as follows (costs inclusive of GST):

- Low cost scenario — $1,591 for $300 and $450 per week properties and $1,733 for $600 per week properties,
- Medium cost scenario — $2,649 for $300 and $450 per week properties and $2,885 for $600 per week properties, and
- High cost scenario — $3,707 for $300 and $450 per week properties and $4,038 for $600 per week properties.

Painting and floor covering replacement

DHA’s fee makes a provision for internal re-painting upon lease expiry for a lease longer than six years. For a lease longer than nine years, it also provides for re-carpeting, replacing vinyl floor coverings or re–polishing timber floors and both internal and external painting (unless a body corporate or similar entity has the responsibility).

DHA data indicates that these end of lease costs in 2013–14 averaged $6,244 (including GST) per property for leases that run for at least six years ($1,041 per annum), and cost $9,821 (including GST) per property with leases for at lease nine years ($1,091 per annum) for a detached house. For a higher spec property renting at $600 a week, these end-of-lease costs have been escalated in a similar fashion to the higher repairs and maintenance costs associated with such a property. With a smaller variation in painting and floor covering replacement, the high and low cost scenarios fall 15% above and 15% below these average costs respectively.

If the above works are required during the life of the lease due to fair wear and tear, and to maintain the property to a high quality standard, DHA will undertake and pay for the works. DHA is still required under its lease agreement to complete end-of-lease works. If, however, it is not deemed necessary (i.e. the property is in good condition), DHA may offer a payout in lieu of undertaking the work.

Vacancy

While a DHA managed property may be vacant in-between tenants, DHA continues to pay rent during this period, subject to the terms and conditions of the lease agreement. In contrast, rent is foregone under a real estate agent management agreement.

The loss of rent in-between tenants over a period is calculated by determining how often there is a change of tenant, and how long the property is empty in-between tenants. The state residential tenancy authorities keep data on registered leases and we can estimate the turnover of tenants by the turnover of leases.

A consistent 9% of all rental bonds are refunded each quarter. However, in areas where there is an oversupply of properties, we have found that bonds turn over more frequently as tenants choose to upgrade their property to either newer or better quality stock at a similar rental level. In contrast, in areas of undersupply and low vacancy, turnover is slightly lower, as tenants choose to stay in their existing property to avoid competing for fewer properties and paying higher rents. This suggests that a little over a third of all tenancies turn over every year. This is backed up by data sourced from bond authorities in both Sydney and Melbourne which indicates that approximately 36% of tenancies run for 12 months or less, a further 30% run for between 13 and 24 months, with the remaining 33% running for 2 years or more.

Therefore, we have assessed that an average tenancy would run for 18 months, and as the tenant turns over, a landlord under a traditional real estate agent management agreement would pay a letting fee. In addition, advertising and lease preparation fees (if required by their agency agreement) would be charged at 18-month intervals throughout the term of their property investment.

In addition, as the property turns over, the property is likely to be vacant. This could be due to the time taken to find a new tenant, or a natural gap between a lease expiry and the date that the new tenant will commence. In a weak rental environment, the landlord may undertake maintenance work or upgrade the property in order to secure a new tenant.

Table 2.2 shows the average vacancy over the 14 years to 2014 by capital city. Vacancy rates fluctuate over time and by capital city. Notwithstanding current vacancy rates, over the most recent 2007 to 2014 period, average vacancy has been particularly low in Sydney, Melbourne and Canberra, whereas Perth and Adelaide have seen little change in vacancy rates and Brisbane and Hobart has seen an increase compared to the previous seven years. Darwin has also seen a large reduction in its vacancy rate, with old and obsolete stock now taken off the market and newer stock more readily rented.

Based on the average vacancy rate in each capital city between 2007 and 2014, this translates to an average period of vacancy ranging from 0.77 weeks in Sydney, to 1.58 weeks in Hobart. Across Australia between 2007 and 2014, an average property is vacant for 1.2 weeks per year.

Table 2.2: Average vacancy rates by capital city, 2000 to 2014

	Sydney	Melbourne	Brisbane	Adelaide	Perth	Hobart	Canberra	Darwin
2000-2014	2.3	2.6	2.4	2.1	3.1	2.6	2.5	4.0
2000-2007	3.0	3.2	2.3	2.1	3.1	2.2	2.7	5.5
2007-2014	1.5	1.9	2.5	2.1	3.0	3.0	2.2	2.4
2007-2014	0.77	1.02	1.30	1.11	1.57	1.58	1.17	1.26
Vacancy cost ($)	345	361	488	359	728	530	515	829

Source: BIS Shrapnel

Based on median house rental levels at June 2014 in the capital cities, the average cost of vacancy to a landlord can be between $345 per annum in Sydney and as high as $829 in Darwin. We have therefore based our low cost scenario on a vacancy of just 0.7 weeks per year, our medium and most likely cost scenario with vacancy of 1.1 weeks per year and our high cost scenario as 1.4 weeks per year. However, these can be higher if vacancy rates reflective of the start of the decade (2000 to 2007) eventuate.

Rental floor

In a traditional rental, there is also the possibility of a landlord taking a lower rent upon re-letting (or the threat of a tenant leaving) in an adverse market. The DHA lease (for a sale and leaseback property) stipulates that when a rent review occurs the greater of market or the commencing rent will be paid. Therefore, the agreement does not provide for rent decreases below the commencement rent.

After examining quarterly median rental price data over the last 14 years we have noted a number of periods in each capital city where median rents fell from their previous highs. This is shown in **Table 2.3**. The number of weeks where rents fell and remained below the previous high varied from just 26 weeks over the entire 14-year period in Sydney, up to 195 weeks in both Melbourne and Brisbane.

Table 2.3: Periods of rent fall over the 14 years to June 2014

	Sydney	Melbourne	Brisbane	Adelaide	Perth	Hobart	Canberra	Darwin
Weeks of rent fall	26	195	195	143	156	169	143	182
Accumulated loss of rent ($)	-195	-1,885	-1,950	-1,040	-1,066	-2,405	-2,470	-4,771

Source: BIS Shrapnel

This suggests that there is a value to the rental floor provided by the DHA lease. However, in practical terms this is difficult to quantify. As the rental floor applies to the commencement rent, the data suggests that after two or three years into the lease, the possibility of rents falling below the commencement rent is negligible. Moreover, a landlord with a long-term tenant may not have to reduce the rent to market even with a real estate agent management agreement, as the cost of moving for the tenant may outweigh the benefit of a lower rent. Consequently, while there is a benefit in having a rental floor, particularly in the early years of a DHA lease agreement, we have not accounted for it in our analysis.

Tenant protection insurance

Tenant protection insurance is a relatively new insurance product, which can be purchased in addition to traditional building cover. It is an extra which protects landlords against unpaid rent (generally limited to between 13 and 15 weeks), and theft or malicious damage to the rental property by the tenant. Landlords with either real estate agent managed properties or self–managed properties are increasingly gaining this extra cover for protection.

DHA's lease includes repairing any damage to the property that arises from negligence or malicious acts by DHA employees, agents or permitted occupants. As the lessee, it is expected that lessor insurance protects the landlord against lost rent due to tenant default. Therefore, this cost that is incurred by a landlord in a traditional residential rental would not need to be paid by a landlord leasing their property a DHA lease.

In order to cost tenant protection insurance, BIS Shrapnel has contacted three of Australia's largest insurance providers and ascertained the spread of costs across both capital cities and the main areas within which DHA operates. Insurance premiums can range from just $100 up to over $600 per annum (incl. GST) with an excess of $200 for detached houses. Therefore we have determined that in a low cost scenario tenant protection insurance will cost $100 (incl. GST), in the medium cost and most likely scenario the cost would be $300 (incl. GST), and in a high cost scenario tenant protection insurance costs $600 (incl. GST) per annum.

While a landlord can opt to not pay landlord insurance, he/she then faces the potential cost associated with a delinquent tenant. Consequently, we have assumed that landlord insurance is taken out, rather than factor in these potential costs.

Hassle

An analysis of the repairs and maintenance costs provided by DHA show that on average there are approximately nine unique items per property per year requiring repair or maintenance across the whole portfolio. This does not necessarily amount to nine "call outs" per property per year, as a number of items can be fixed at the same time. Consequently, there are likely to be less than nine actual "call outs" per property per year. Nevertheless, a landlord of a real estate managed property in most cases would be required to approve and sometimes organise this work, whereas this is all paid for and handled within the DHA fee. Some properties would have no issues come up during the year, while others would have many and require a considerable number of hours of the landlord's attention.

To cost this 'hassle' component, we have determined three scenarios:

- in a low cost scenario, there would be no time required by a traditional landlord,
- in a medium and most likely situation a landlord would require three hours per quarter (12 hours per year) to manage repairs and maintenance tasks; and;
- in a high cost scenario, the time required would be six hours per quarter (24 hours per year).

Based on weekly ordinary earnings of a full-time working adult in Australia, the average pay rate is $38.8 per hour, which we have adopted as an estimate of the value of the time required by a landlord to fulfil the same duties performed by DHA when organising and managing repairs and maintenance of an investment property.

Costs outside both the DHA model and traditional real estate model

It should be noted that there are a number of costs that both the DHA lease and traditional real estate agent agreements do not cover. These include council rates, strata and sinking fund levies (where required), provision of service charges by utility companies, pest inspections and building insurance. These are all costs, which will impact on the final cash flow position of a typical residential investment. However, for identical properties, they will be identical whether they are under a DHA lease or a real estate agent management agreement.

3 RESULTS OF COST COMPARISON

By calculating all the identified additional costs that DHA's fee covers and adding these costs to a traditional real estate agent's fee, we can determine the comparable 'like-for-like' cost of management.

As discussed, there is considerable variation in costs, due largely to location, but also in vacancy levels, quoted percentage of rent rates and additional charges by real estate agents, and rental ranges. Therefore, we have provided three scenarios which provide a low, medium and most likely, and high range of costs associated with a residential investment property. We have also provided each of these scenarios for three different rent levels, which most reflect the stock of properties leased by DHA, and are reflective of common rents across Australia's capital cities and regional areas.

Table 3.1 shows the most likely, medium cost scenario including the assumptions discussed earlier for each cost item after nine years of leasing the investment property. It shows what the total (explicit and implicit) cost of managing a typical investment property over the course of the lease and providing all the benefits associated with DHA's lease, via a real estate agent, would cost (including GST where applicable):

- $6,440 per annum for a property earning $300 a week, equivalent to 41.1% of gross income;
- $7,375 per annum for a property earning $450 a week, equivalent to 31.4% of gross income;
- $8,643 per annum for a property earning $600 a week, equivalent to 27.6% of gross income.

Table 3.1: Medium and most likely cost scenario for detached houses (current dollars per annum) – Year 9 (includes GST where applicable)

Weekly rent	**$300**	**$450**	**$600**
Gross rent per annum (52.18 weeks)	15,654	23,480	31,307
Cost item ($)			
Traditional agent			
Management fee (8.25%)	1,291	1,937	2,583
Vacancy costs (1.1 weeks p.a.)	330	495	660
Admin fee ($5.50 per month)	66	66	66
Letting fee (1.5 weeks rent every 18 months)	248	371	495
Tenant protection insurance ($300 p.a.)	300	300	300
Repairs and maintenance	2,649	2,649	2,885
Nine year make good (internal and external repaint and flooring)	1,091	1,091	1,189
Hassle (12 hrs per annum at full time average hourly wage)	465	465	465
Total	6,440	7,375	8,643
% of gross rent	41.1	31.4	27.6
Defence Housing Australia			
Fee	2,583	3,874	5,166
% of gross rent	16.5	16.5	16.5
Cost saving through DHA management agreement	**3,857**	**3,500**	**3,477**

Source: Defence Housing Australia, BIS Shrapnel

Under all of these rent ranges the DHA fee of 16.5% of gross income is notably lower, producing considerable cost savings per annum.

However, due to variations in potential costs it is important to consider the low and high cost scenarios. **Table 3.2** and **Table 3.3** show the low and high cost scenarios respectively, based on the average ranges of costs from the medium scenario.

Table 3.2: Low cost scenario for detached houses (current dollars per annum) – Year 9 (includes GST where applicable)

Weekly rent	$300	$450	$600
Gross rent per annum (52.18 weeks)	15,654	23,480	31,307
Cost item ($)			
Traditional agent			
Management fee (6.6%)	1,033	1,550	2,066
Vacancy costs (0.7 of a week p.a.)	210	315	420
Admin fee (none)	0	0	0
Letting fee (1 week rent every 18 months)	165	248	330
Tenant protection insurance (100 p.a.)	100	100	100
Repairs and maintenance	1,591	1,591	1,733
Nine year make good (internal and external repaint and re-flooring)	928	928	1,010
Hassle (none)	0	0	0
Total	4,026	4,730	5,659
% of gross rent	25.7	20.1	18.1
Defence Housing Australia			
Fee	2,583	3,874	5,166
% of gross rent	16.5	16.5	16.5
Cost saving through DHA management agreement	**1,444**	**856**	**494**

Source: Defence Housing Australia, BIS Shrapnel

In a low cost scenario, the real estate agent costs (including GST where applicable) to manage a typical investment property and provide the extra benefit covered by DHA Property Care are:

- $4,026 per annum for a property earning $300 a week, equivalent to 25.7% of gross income;
- $4,730 per annum for a property earning $450 a week, equivalent to 20.1% of gross income;
- $5,659 per annum for a property earning $600 a week, equivalent to 18.1% of gross income.

Given all costs could be kept to the lower end of the scale, under all of these rent ranges, over a nine year lease, the DHA fee of 16.5% of gross income continues to be lower than the comparison total cost of managing an investment property using a traditional real estate agent.

In contrast, the high cost scenario (**Table 3.3**) shows that at the opposite end of the spectrum, costs using a traditional real estate can become significant.

Table 3.3: High cost scenario for detached houses (current dollars per annum) – Year 9 (includes GST where applicable)

Weekly rent	$300	$450	$600
Gross rent per annum (52.18 weeks)	15,654	23,480	31,307
Cost item ($)			
Traditional agent			
Management fee (9.35%)	1,464	2,195	2,927
Vacancy costs (1.4 weeks p.a.)	420	630	840
Admin fee ($8.80 per month)	106	106	106
Letting fee (2 weeks rent every 18 months)	330	495	660
Tenant protection insurance (600 p.a.)	600	600	600
Repairs and maintenance	3,707	3,707	4,038
Nine year make good (internal and external repaint and flooring)	1,255	1,255	1,367
Hassle (24 hrs. per annum at full time average hourly wage)	931	931	931
Total	8,811	9,918	11,468
% of gross rent	56.3	42.2	36.6
Defence Housing Australia			
Fee	2,583	3,874	5,166
% of gross rent	16.5	16.5	16.5
Cost saving through DHA management agreement	**6,229**	**6,044**	**6,303**

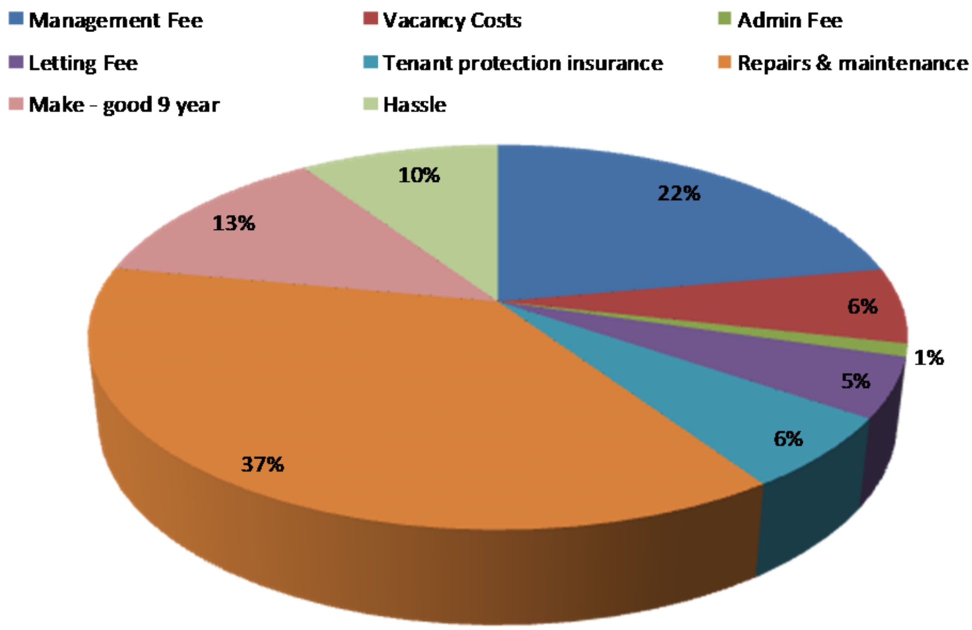
Source: Defence Housing Australia, BIS Shrapnel

Under a high cost scenario, with a property renting at $300 a week, costs would equate to 56.3% of the gross rent. At $450 per week, the equivalent ratio would equal 42.2% of gross rent and at $600 a week, 36.6% of gross rent. While these comparison rates seem high, they are not the most extreme. As stated previously some agents charge management rates, (particularly in Canberra and Perth) far above the 9.35% (incl. GST) rate used in the scenario above, admin fees and letting fees in many cases are higher, vacancy can often occur for more than 1.4 weeks per year and repairs and maintenance, particularly in the Northern Territory, can be significantly higher. Therefore, while this provides a typically higher cost scenario, many properties would have higher costs than those illustrated.

Chart 3.1 shows the breakdown of costs for a $450 per week rental property assuming the most likely, medium cost scenario in year nine of the lease term. It shows that while management fees make up 22% of the total costs associated with a traditional rental property, ongoing repairs and maintenance make up a larger proportion at 37%. The value of the nine-year end of lease expenses of internal and external repainting and floor covering replacement represents 13% of total costs.

As shown earlier in **Table 2.2** vacancy rates have been lower in the last seven years than over the long-term, 14-year average. Assuming the lower average vacancy rate experienced over the last seven years continues though the nine-year lease term, the cost of rent foregone during periods of vacancy will comprise an average 6% of total costs. A further 6% of costs are expended on tenant protection insurance in order to insure against the costs of a delinquent tenant. The value of the landlord's time to address issues in repairs and maintenance and other incidental issues (i.e. hassle, contributes 10% to costs, and letting fees and administration fees make up a further 5%).

Chart 3.1: Share of standard annual tenancy costs $450 per week – Year 9 – medium scenario



Source: Defence Housing Australia; BIS Shrapnel

4 COMPARISON WITH MANAGED FUNDS

Investors have the option of other investments outside of residential property, including managed investments. These include retail managed funds, and various types of superannuation funds. This section compares the DHA fee charges as part of a DHA residential investment with the fees associated with managed investments.

The fee structure of a DHA investment versus managed fund investment is not directly comparable as the DHA fee is determined as a percentage of gross rental income, while the fees associated with a managed fund are determined as a percentage of assets under management.

The Financial Services Council monitors the fees charged by managed funds through published Australian Prudential Regulatory Authority (APRA) statistics and information supplied in product disclosure statements, annual reports and surveys through the commissioning of a report prepared by Rice Warner Actuaries.

The report prepared for the Financial Service Council details fees charged by different managed fund segments as a percentage of total assets under management in the year ending June 2013, and how the fees have changed since 2006.

Table 4.1: Annual fees by managed fund segment (%), 2006 to 2013 (includes GST)

Sector	Segment	2006	2008	2010	2011	2013
Wholesale	Corporate	0.78	0.73	0.80	0.79	0.78
	Corporate Super Master Trust (Large)[1]	0.81	0.79	0.87	0.83	0.86
	Industry	1.13	1.07	1.26	1.13	1.07
	Public Sector	0.70	0.69	0.81	0.82	0.76
Retail	Corporate Super Master Trust (Medium)[2]	1.83	1.87	1.95	1.83	1.30
	Corporate Super Master Trust (Small)[3]	2.04	2.16	2.41	2.21	1.69
	Personal Superannuation	2.12	2.00	2.07	1.87	1.73
	Retail Retirement Income	1.79	1.84	1.85	1.75	1.71
	Retirement Savings Accounts	2.30	2.30	2.30	2.30	0.70
	Eligible Rollover Funds	2.53	2.49	2.42	2.40	2.43
Small funds	Self-managed super funds	0.87	0.98	1.01	1.00	0.95
Total		**1.27**	**1.21**	**1.27**	**1.20**	**1.12**

Source: Rice Warner Actuaries – Superannuation Fees Research June 2013; BIS Shrapnel

[1] Excludes employer plans with less than $5 million in assets.

[2] Employer plans with assets between $2 million and $5 million.

[3] Employer plans with less than $2 million in assets.

The research shows that wholesale trusts managed in the public sector have the lowest managed fund fees as a percentage of total assets. In contrast eligible rollover funds in the retail sector have the highest fees as a percentage of total assets. In general, the average fees charged by managed funds have reduced from 1.27% in 2006 and 2010 to 1.20% in 2011 and were at 1.12% in the year ending June 2013 (all percentages include GST).

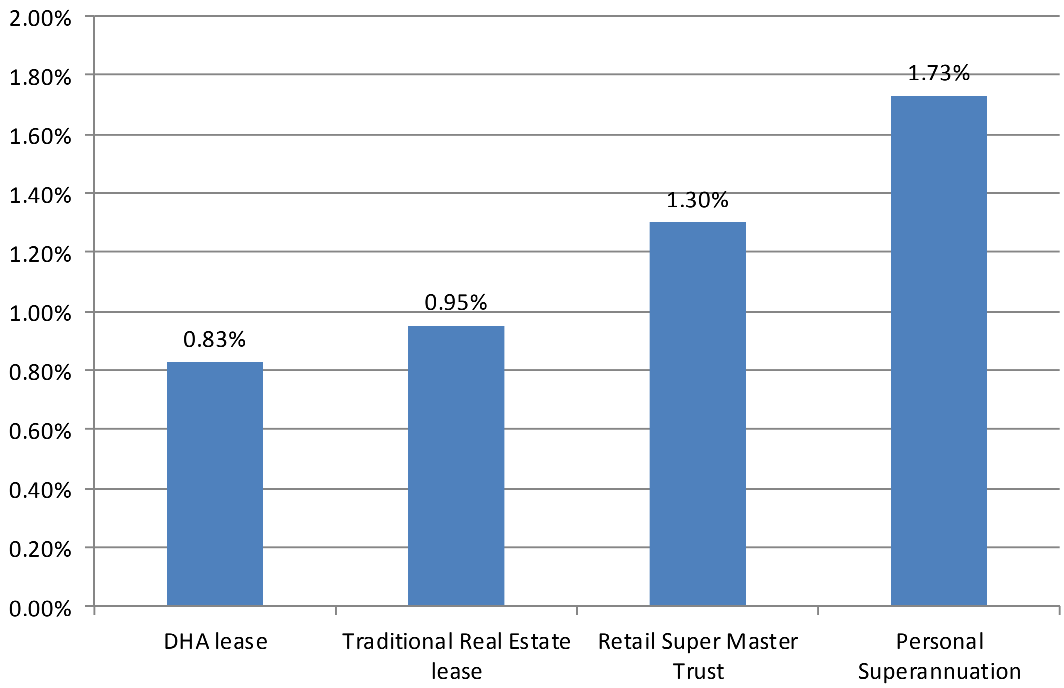
We have also compared the management fees with a sample of funds from the major managers to confirm against the quoted management fees in **Table 4.1**. AMP, Macquarie, MLC, Colonial, Macquarie, BT, and Perpetual all had similar management fee ratios, with retail fees falling into the 1.66% to 2.03% (incl. GST) of total assets range.

To provide a meaningful comparison with DHA's fee, we have made an analysis of all the properties that have been sold and leased back by DHA between July 2013 and September 2014 (just over 900 properties). These properties have a recent market valuation and rental return and therefore the service fee charged by DHA (i.e. 16.5% of rent) can be compared to the value of the properties (i.e. the assets that are under management). The value is taken as the average value of all properties applicable to that rent range.

In order to make a comparison with these alternative investment options, **Chart 4.1** shows DHA's fee and the total management costs of a traditional real estate agent management agreement (under a medium cost and rent scenario), calculated earlier, expressed as a percentage of the estimated average value of assets under management. In this instance, it represents an indicative value of the dwelling.

The chart indicates that retail master trusts and personal superannuation funds have higher management fees in general when compared to DHA's lease and traditional real estate leases.

Chart 4.1: Alternative investment fees as a % of assets (includes GST)



Source: Rice Warner Actuaries; BIS Shrapnel