Making housing assistance more efficient

BY SYSTEMATICALLY MIXING AND MATCHING HOUSING SUBSIDY PROVISIONS TO THE HOUSING MARKET CONDITIONS THAT PREVAIL IN DIFFERENT CAPITAL CITIES, MORE HOUSEHOLDS CAN BE ASSISTED WITH THEIR HOUSING FOR THE SAME AMOUNT OF MONEY.

KEY POINTS

• The real value of housing assistance has fallen in Australia over the past decade, placing a premium on making housing assistance as efficient as possible.

• The main approaches to providing housing assistance include capital grants to social housing agencies, rent assistance to eligible tenants, subsidised home purchase and subsidised shared equity schemes. Each of these gives rise to a separate set of financial and operational ‘risks’ for government.

• The main systematic risks to the cost efficient delivery of housing assistance are: movements in interest rates, inflation, dwelling values (capital gains or losses), rental yields, tenant unemployment, tenant income levels, dwelling construction and maintenance costs, and rental vacancy rates.

• The policy challenge is to work out how these risks affect the cost of the various housing assistance policy options and to select the option or mix of options that is most likely to maximise the efficient use of government assistance funds, while still ensuring that eligible households can access housing at an affordable price.

• This research demonstrates that targeting the mix of housing assistance delivered in different capital cities is likely to achieve significant efficiency gains. The cities analysed are: Sydney, Melbourne, Adelaide, Brisbane, Canberra, Hobart, Perth and Darwin.

BACKGROUND

Previous AHURI research has found that housing affordability is declining in Australia for many lower income households, especially those renting in the private sector (see for example Burke and Ralston, 2003). Already, governments in Australia spend about $3 billion a year to assist both public and private tenants.

A traditional approach to the design and implementation of housing assistance packages tends to treat each option as a stand-alone alternative. This does not provide a framework or method for systematically evaluating and comparing the likely costs to government, over the longer term, of alternative housing assistance options and combinations of options. Such a framework would also need to encourage policy makers to take into account the factors that determine program cost outcomes across housing markets in different areas, which can be quite different from one another.
The cost effectiveness of any housing assistance measure will be significantly affected by changes in economic variables such as interest rates, building costs and housing prices. These changing economic variables are not fully predictable. There is a risk or unexpected volatility attached to each that can take the form of ‘upside’ or ‘downside’ risk. Upside risks refer to unexpected outcomes such as lower than expected borrowing costs. Above expected program costs provide an example of downside risk. When designing housing assistance programs, governments need to know:

- the most likely cost outcomes (including best and worst case outcomes);
- where cost savings are achievable, and their size; and,
- what the most cost effective or efficient policy mixes are likely to be.

This study developed a model to investigate the most efficient housing assistance ‘policy mix’ in eight major cities – Sydney, Melbourne, Adelaide, Brisbane, Canberra, Hobart, Perth and Darwin. The study also assessed whether there are specific policy mixes that are more efficient in any of the cities than the current dual focus on rent assistance paid to eligible private tenants and capital funding provided to state housing authorities to house public tenants.

**METHODOLOGY**

A model was developed to assess the cost effectiveness of five housing assistance options, including rent assistance, subsidised home loans, grant-funded public housing, debt option and shared equity (a 50/50 mix of home loans and grant funding of public housing). Specific sets of scenarios defined for key risk variables such as inflation, rental growth, interest rates and tenant incomes were also constructed. Drawing the housing assistance and risk data together, a probability approach (based on analysis of a hundred housing assistance mix scenarios for each of Sydney, Melbourne, Adelaide, Brisbane, Canberra, Hobart, Perth and Darwin, respectively) was used to explore the effect of changes in risk variables on single and various combination options of housing assistance.

The subsidy-driven policy options costed in the research are:

- on-budget (grant funded) public housing;
- off-budget bond funded social housing (‘the Consortium model’);
- rent assistance;
- home loan option;
- shared equity option – a combination of on-budget public housing and subsidised home loans);
- ‘all options mixed option’ – arbitrarily created by dividing the total subsidy evenly across the above five basic options;
- ‘partial mixed option’ – a split of subsidy between rent assistance and on-budget public housing broadly reflecting the current division of housing assistance between these two options in the CSHA and Commonwealth Rent assistance programs; and
- ‘best two case’ – a 50/50 split of subsidy between the two most efficient of the five basic options for each of the eight cities.

The results indicate, first, whether a changed mix of housing assistance that takes account of capital city-specific risks will lead to cost savings for government, and; second, what the likely size of any such savings would be.

**FINDINGS**

The research revealed a diversity of efficiency outcomes. Due to the make-up of the tenure mix in each of the capital cities modelled, and the ways these interact with key risks, the probabilities and subsidy savings found in each city vary.

Looking at the likelihood of savings:

- in more than half the cases, the ‘all options mixed’ option delivered lower assistance costs than home loans, rent assistance and shared equity in six of the eight cities. The two exceptions were Adelaide and Hobart, in which only rent assistance delivered cost savings over the ‘all options mixed’ choice in more than half of cases.
- in the other six cities, the bond funded and on-budget public housing options delivered lower assistance costs than the other three options and ‘all options mixed’ option in at least 65% of cases.
- in Sydney and Melbourne, bonds and public housing were cheaper than the ‘all options mixed’ option in more than 90% of cases, indicating a very high probability that these former options would generate cost savings compared to the other basic options and the mixed option.

Aggregating across all eight cities (on an unweighted basis):

- Only the public housing and bonds options generated savings over the ‘all options mixed’ option in more than half of cases; indeed, both generated savings in more than 70% of cases.
- The home loan option was the least likely option to deliver savings (it did so in only 14% of cases).
- The ‘all options mixed’ option delivered cheaper assistance outcomes than all the individual options
in 52% of cases and the ‘partial mixed option’ (reflecting the current Commonwealth mix of public housing and rent assistance) in 45% of cases.

- However, the ‘best two cases option’ generated savings over the ‘partial mixed option’ in almost two-thirds of cases. This suggests that there is a high probability of reducing housing assistance costs per assisted household if governments tailored policies to deliver assistance in each city by focusing on the two most efficient options in each case: bonds and public housing in Sydney, Melbourne, Perth, Brisbane, Canberra and Darwin; rent assistance and bonds in Adelaide; rent assistance and home loans in Hobart.

Looking at the size or impact of the probable cost savings:

- Aggregating for all eight cities, the average savings in assistance costs by:
  - the ‘all options mixed option’, in the cases where savings are achieved, range from a low of 8.5% over shared equity to a high of 62.6% over rent assistance.
  - the ‘all options mixed option’ over the partial mixed option is 62%
  - the ‘best two cases’ option over the partial mixed option is 95.8%. That is, for any given total subsidy amount, almost twice as many households could be assisted by using the best two options in each city, rather than by dividing the total subsidy between rent assistance and public housing in similar proportions to the current CSHA/CRA split.

- The ‘best two cases option’ delivers the following savings over the ‘partial mixed option’ in each city: Adelaide (53%); Melbourne (139%); Sydney (112%); Canberra (57%); Hobart (26%); Perth (202%); Darwin (87%); Brisbane (92%). Note a savings outcome of more than 100% means that the average assistance cost for the option in question is less than half the cost of the other option. A saving of more than 200% means a cost of less than a third, and so on.

By averaging the assistance costs for each option across all 100 cases for each city the average cost per option can be calculated. The table below ranks the five basic options and all options mixed option for each city, in terms of their relative subsidy efficiency. It can be seen that the bond and public housing options deliver the cheapest cost for all but two cities (Adelaide and Hobart). Not only are these two options likely to generate savings in those six cities, but when they do, the level of savings is high.

The average annual assistance cost per assisted household for all capital cities taken together was calculated as:

- $1,200 for both the bond and public housing options;
- $2,000 for the all options mixed option;
- $2,200 for the shared equity option;
- $2,500 for rent assistance;
- $3,100 for the home loan option;
- $1,930 for the partial mixed option; and
- $1,010 for the best two cases option.

Taking all cases, a policy of delivering housing assistance through the best two options for each city would support almost twice as many assisted households as the current split between rent assistance and public housing (assuming that a common affordability benchmark is met in all cases).

An analysis of the worst case focuses on downside risk, and also highlights capital city variation:

- The home loan option carries the greatest downside risk in Melbourne, Sydney, Canberra, Perth and Darwin and Brisbane and the second highest risk in the other two cities.

- The bond-funded option has considerably higher downside risk than on-budget public housing, with the highest exposure in Hobart and the second highest exposure in Melbourne, Canberra, Perth, Darwin and Brisbane. Public housing has the lowest downside risk in Melbourne, Sydney, Perth, Darwin and Brisbane and the second lowest exposure in the other three cities.

- The situation with rent assistance is the reverse of the public housing case: i.e. lowest risk in Adelaide, Canberra and Hobart and second lowest in the other five cities.

Other findings include:

- Looking at the initial incomes of target households: the relative efficiency of the various assistance

| Ranking of Housing Assistance Policy Options by Real Mean Annual Subsidy Cost per Resident: Individual Options and ‘All options mixed’ Option, Eight Australian Capital Cities. |
|-----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Option          | Adelaide       | Melbourne      | Sydney         | Canberra       | Hobart         | Perth          | Darwin         | Brisbane       |
| RA              | 1              | 5              | 6              | 5              | 1              | 5              | 6              | 5              |
| Public Housing  | 5              | 2              | 2              | 1              | 5              | 2              | 1              | 2              |
| Bonds           | 6              | 1              | 1              | 2              | 6              | 1              | 2              | 1              |
| Home loans      | 3              | 6              | 5              | 6              | 3              | 6              | 3              | 6              |
| Shared Equity   | 4              | 4              | 4              | 4              | 4              | 4              | 5              | 4              |
| ‘All options’   | 2              | 3              | 3              | 3              | 2              | 3              | 4              | 3              |
options in each city did not change. That is, the relative cost savings were similar regardless of whether household income was assumed to be $15,000, $25,000 or $35,000.

• Similarly looking at the length of the period over which housing assistance is delivered – with the exception of home loans – the relative subsidy efficiencies did not change for the eight options across the eight cities.

CAVEATS

At the time of the study results suggest a mixed, targeted approach to housing assistance would be likely to result in efficiency gains through cost savings, and improve the current ‘two arms’ strategy.

The analysis presented in this study assumed that the risk characteristics of the past 20 years will be reproduced in future years. This period included years of high inflation and interest rates (especially the late 1980s), which may not reappear in the next 20 years, given that the Australian economy has, of late, experienced historically very low inflation and interest rates. The model developed in this study can readily be adapted to explore the relative subsidy efficiencies of different policy options under different sets of assumptions about future risks.

POLICY IMPLICATIONS

The research demonstrates that the long-term output efficiency of housing assistance policy can be improved through more flexible, differentiated assistance policies that target capital city housing market conditions.

A sophisticated risk management approach applied jointly by the Australian Government and States and Territories could see the operation of all of the main types of housing assistance maintained and monitored, with the emphasis changed between program elements as economic circumstances change.

Whilst implementation of such an approach is difficult to envisage within the current constraints of housing assistance policy, the value of this research is that it demonstrates that housing assistance policy operates within the context of a housing market and the conditions of that market vary over time and by location. Given this, if flexible switching between forms of housing assistance is not possible in the short term, then a strategy of risk minimisation, of not putting all our housing assistance ‘eggs in one basket’, is appropriate.

FURTHER INFORMATION

This bulletin is based on AHURI projects 30096 and 30204, both entitled Risk Management and Efficient Housing Assistance: a new methodology. Reports from these projects can be found on the AHURI website (www.ahuri.edu.au) by typing either of the project numbers into the search function.

The following documents are available for each project:

• Positioning Paper
• Final Report

See also:


Or contact the AHURI National Office on +61 3 9660 2300.