

Final Report

Housing affordability: a 21st century problem

National Research Venture 3: Housing affordability for lower income Australians

authored by

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1 OVERVIEW

This report provides an overview of the major findings that have emerged out of the third AHURI-funded National Research Venture (NRV3), Housing Affordability for Lower Income Australians. It identifies the major risks and challenges in relation to Australia's housing problem in the 21st century, as well as drawing out policy implications.

The major conclusions of the three-year NRV3 research program are as follows:

- Housing affordability is a large and widespread problem.
- Housing affordability is a structural problem.
- Causes of affordability problems are complex and diverse. Major driving factors can be found both within the housing system and beyond it.
- Housing affordability problems are predicted to increase in the first half of the 21st century as a result of anticipated demographic and housing market changes.
- Affordability problems have specific spatial and cyclical dimensions.
- Households most at risk of facing the multiple problems that arise from a lack of affordable housing are lower-income households in the private rental market.
- Housing markets have failed to provide an adequate supply of affordable housing for lower-income households.
- Individual households experience and address housing affordability problems in different ways.
- While housing provides shelter, it also influences a raft of non-shelter outcomes for individual households, such as workforce participation, access to jobs and services, family stability and educational attainment.
- Declining affordability has implications for economic performance and labour market efficiency, social cohesion and polarisation of cities, environmental considerations and the creation and distribution of wealth through home ownership.

Together these conclusions explain the title given to this report: housing affordability is a 21st century problem.

1.1 Research approach

The central aim of NRV3 was to undertake evidence-based research on housing affordability in order to inform the development of policies that can effectively address housing affordability problems for lower-income Australians.

1.1.1 Research questions

The overarching research question guiding NRV3 was:

How do we assess and address housing affordability for lower-income households in Australia?

This question was broken down into six logically connected, researchable areas:

1. How is the problem conceptualised?
2. What are the drivers of affordability problems?

3. Why does affordability matter?
4. Who has an affordability problem? How has this changed over time?
5. What are the projected affordability problems into the future?
6. How do we assess policies intended to improve affordability?

These research questions were addressed in a series of research papers, identified in this report as RP1 to RP11. A full list of these research papers and their authors is provided in Appendix 1.

This final report draws together the results of this research program to provide answers to the overarching question addressed by the research.

Figure 1.1: Research Papers



1.1.2 Research stages

The research was undertaken in three linked stages. Stage 1 provided the background and conceptual framework for NRV3. During this stage, the research team identified objectives that might underpin a national affordable housing strategy, summarized the broad range of policies available for addressing affordability problems and developed a framework for evaluating policy initiatives. Stage 2 provided evidence on the extent and impact of housing affordability problems in Australia through both quantitative and qualitative research. It also provided evidence to show why housing affordability is a problem that needs to be addressed. Stage 3 combined evidence on the socio-demographic, economic and market drivers of affordability problems with evidence on the characteristics of households who currently face housing affordability problems to provide an indication of the extent to which affordability problems are likely to persist into the future. (Further detail on each stage is provided in the Appendix.)

Table 1.1: Research stages, questions and outputs

<i>Research stage</i>	<i>Research questions</i>	<i>Research outputs</i>	<i>Final Report</i>
Stage 1	1. How is the problem conceptualised?	NRV3 plan NRV3 RP1	Chapter 3
	6. How do we assess policies intended to improve affordability?	NRV3 RP2 NRV3 RP7	Chapter 5
Stage 2	2. What are the drivers of affordability problems?	NRV3 plan	Chapter 2
	3. Why does affordability matter?	NRV3 plan NRV3 RP4 NRV3 RP5	Chapter 3 Chapter 4
	4. Who has an affordability problem? How has this changed over time?	NRV3 RP9 NRV3 RP3 NRV3 RP6 NRV3 RP9 NRV3 RP10	Chapter 3
Stage 3	5. What are the projected affordability problems into the future?	NRV3 RP11	Chapter 3

1.1.3 Research strategy

The results from NRV3 are based on an integrated approach incorporating:

- Literature reviews that place the issues covered by the research in a broad perspective
- Quantitative analyses undertaken at a national level that identify the potential size of the housing affordability problem in Australia and households most affected

- Supplementary, focused quantitative and qualitative surveys to identify those experiencing problems and to learn about their experiences.

At all stages during the research there was extensive consultation with a wide range of stakeholders. This involved by-invitation workshops, meetings with the policy research working group (PRWG) that reports to Housing Ministers, and having a representative of the PRWG participate in biannual research team meetings. Preliminary findings were disseminated through regular teleconferences with a representative user group drawn from the PRWG, to a broader audience through presentations by team members at seminars and conferences around Australia and internationally, and through publication of the research papers on the AHURI website as they were completed.

1.2 Key research findings

The evidence-base generated through the NRV3 research process clearly indicates that housing affordability is an endemic and structural problem that will not be improved without adjustments to existing policies and additional action by governments at all levels. A list of the key research findings that have contributed to this understanding is presented below. Further contextual information about these findings is presented in Chapters 3 and 4 and within the relevant research reports.

1.2.1 *Conceptualising and measuring housing affordability*

- Housing affordability is a tenure-neutral term that denotes the relationship between household income and household expenditure on housing costs. Typically, housing affordability indicators rely on a ratio measure that specifies the acceptable proportion of income to be spent on housing, or on a residual measure that refers to an acceptable level of absolute residual income once housing costs have been met. (RP1)
- The average amount spent on housing costs across all households in Australia has increased gradually from around 11 per cent of household income in the mid-1970s to just over 15 per cent in 2003-04. (RP3)
- Currently around 15 per cent of all households pay twice as much as this – that is, they pay at least 30 per cent of their income in meeting their housing costs. This percentage has remained relatively stable over the past decade. For lower-income households this proportion (at 28 per cent) is almost double the Australia-wide average. This proportion has increased from 24 per cent over the past decade. In other words, the proportion of households with high housing costs in relation to their income is polarised and polarising. (RP3, RP8)
- Under scenarios consistent with the demographic and economic trends employed in the Australian Government's Intergenerational Reports, the proportion of lower-income households with a ratio of housing costs to income of more than double the Australia-wide average could increase by more than 20 per cent by the time those who are now 25 turn 65. (RP11)
- Housing stress, defined by the 30/40 rule (based on housing costs of at least 30 per cent of income and focusing on households in the bottom 40 per cent of the income distribution adjusted for household size), is a conservative and robust broad brush indicator of the number of households potentially at risk of housing affordability problems.¹ (RP3)
- In 2002-03, a total of 860,000 lower-income households in Australia were in housing stress and at risk of housing affordability problems. Many moderate-income households – over 150,000 – were also at risk. (RP3)

- Under realistic scenarios, these numbers could double in the next 40 years. (RP11)

1.2.2 Experiencing housing affordability problems

- Broad brush measures cannot explain the factors that determine the level of expenditure on housing, tell little about the implications of being in housing stress, and do not capture the subjective experience of affordability problems. These measures need to be complemented by disaggregated results, which identify household types most at risk. (RP1, RP3, RP6, RP9)
- Housing stress can be measured in terms of people's subjective experience of managing their housing costs. Perceptions of being in housing stress vary across the population, with some moderate-income householders viewing themselves as being in housing stress despite not being included in the 30/40 rule. To a far lesser extent, some low-income households with high housing costs do not view themselves as being in housing stress. (RP6, RP9)
- Housing affordability problems arise when households are forced into decisions that adversely affect them and that they would not make had they not been in housing stress. Examples are various forms of deprivation, such as going without meals, children missing out on school activities and enforced household mobility, that arise when housing stress results in financial stress. (RP6, RP9)
- Approximately one-quarter of households in housing stress experience such housing affordability problems. (RP9)

1.2.3 Identifying households at risk

- Housing stress and housing affordability problems are concentrated among defined sub-groups. Of lower-income households, these include young, single people, households with children, private renters, purchasers, working households and households in the larger capital cities. (RP3, RP9)
- Of those at risk, lower-income renters have more intense and widespread problems than do lower-income purchasers. Many in private rental no longer aspire, or are no longer able to aspire, to home ownership. (RP9)
- It is estimated that approximately 50 per cent of private renter households in housing stress experience severe housing affordability problems. (RP3, RP9)
- Those renters classified in the report as 'strugglers' are most at risk. They have trouble meeting rent payments and suffer higher levels of financial stress. (RP9)
- Low income and a lack of secure, affordable private rental housing contribute to their problems. (RP3, RP6, RP9)
- For many lower-income households, housing stress is a long-term rather than a short-term problem. There is a 60 per cent chance that a household in stress in one year will be in housing stress in at least one of the next 2 years (RP3). Almost 70 per cent of households surveyed saw their housing cost problems as ongoing. (RP9)
- Lower-income purchasers have become increasingly vulnerable to risk associated with a lack of security about their housing, manifest in an inability to meet increases in interest rates. Purchasers classified as 'stretched' (accounting for 20–25 per cent of purchasers surveyed) are most vulnerable, with a quarter of these already in dire straits. (RP9)
- Many households pragmatically avoid severe affordability problems arising from housing stress by making trade-offs (such as renting rather than purchasing, locating in affordable areas or postponing having children). Pragmatic and

aspirant purchasers (accounting for 60 per cent of renters surveyed) fall into this category as do focused and ambivalent purchasers (accounting for 60 per cent of purchasers surveyed).² (RP9)

1.2.4 Why housing affordability is a problem

- Not all of the risks associated with housing affordability problems are borne by individual households. Many are borne by society. (RP4, RP5, RP10)
- Some of the coping strategies employed (such as frequent moves) can contribute to a lack of social cohesion. (RP9)
- Intergenerational equity is compromised by the increasing disparities between those who gain access to home ownership and those who do not. (RP10, RP11)
- Processes of gentrification that have pushed much affordable housing to the fringe in urban areas have contributed to spatial polarisation. Resultant difficulties in recruiting labour have the capacity to constrain economic growth. (RP5)
- Housing affordability problems have the capacity to make it more difficult to manage the economy as a result of the increased sensitivity of at-risk households to policy changes. (RP4)

1.3 Policy risks, challenges and implications

The evidence-base generated through the NRV3 research process signals a number of risks and challenges that arise from the current system of housing provision in Australia and are projected to continue into the future. It provides a compelling case for the need for governments to ameliorate the current and long-term housing affordability problems being experienced by many lower-income renters and, to a lesser extent, marginal home buyers. Some of these risks, challenges and policy implications are summarised below, with further detail provided in Chapters 4 and 5.

1.3.1 Selected risks

- Rents may rise faster than incomes. For some renters, this may lead to forced moves, increased commuter journeys, increased environmental costs and increased social polarisation.
- House prices may rise faster than incomes. For aspirant purchasers, this will reduce their capacity to save and bridge the deposit gap, create blocked aspirations and, potentially, add to frustration and increased tensions between renters and owners. Ultimately it may put pressure on retirement income policies.
- Interest rates may increase. For aspirant purchasers, this will reduce the size of the loan they can borrow and reduce their access to home ownership. At the same time, it may lead to a reduction in the supply of affordable rental housing, either because rents increase or because landlords leave the market. For purchasers who are financially stretched, it reduces their capacity to meet mortgage repayments, impinges upon non-shelter outcomes (such as health and education) and may lead to increased repossessions.
- Declining housing affordability may affect economic performance and labour market efficiency. It may be a driving factor contributing to social exclusion and spatial polarisation.

1.3.2 Selected challenges

Many factors contribute to housing affordability problems. While some arise within the housing system, such as the failure of the housing market to provide an adequate supply of well-located affordable housing, others arise from outside the housing

system and highlight the need for policy actions to address interactions between the housing system and broader economic, social and environmental goals of government. These observations raise a number of challenges for policy.

- Policies need to be sufficiently responsive. They need to be able to respond to the profound changes that have taken place in family structures, labour markets and housing markets over the past few decades.
- Policies need to rise to the immediate challenge of improving affordability outcomes for those currently in housing stress and to the long-term challenge of improving affordability outcomes.
- Policies need to provide opportunities for housing security and wealth creation in an environment where not everyone who aspires to enter home ownership will be able to do so.

1.3.3 Selected policy implications

The final chapter of this report presents a number of broad principles to guide a strategic policy response to the challenges of declining housing affordability in Australia. Further details can be found in RP2 and RP7.

These principles include the following:

- The goal of improving housing affordability cannot be addressed in isolation from other objectives of governments.
- Policy responses need to be multifaceted and integrated – both housing and non-housing policy levers will be required.
- A strategic framework for policy development is required to promote cohesive action and avoid fragmentation of policy responses.
- Housing policies that assist individual households need to be responsive to their changing needs.
- Income support policies alone will be insufficient to address the underlying causes of declining housing affordability.

Because housing affordability both affects and is affected by a broad range of factors, comprehensive strategies are required.

- These need to be developed and implemented cohesively.
- They will require strong coordination and cooperation between agencies and spheres of government.
- An integrated approach to intervention on both the supply and demand side will be needed.

In view of these principles, some potential policy options might include:

- Revitalising policies to support forms of home ownership. These could focus on enabling aspirant purchasers to obtain equity in their homes, mitigating risks to loss of equity when a household's circumstances change, and smoothing a household's transition across tenures.
- Developing a framework for long-term renting. This could focus on putting into place institutional and subsidy arrangements to attract institutional investment into well-located, affordable rental housing and on boosting the capacity of the not-for-profit sector or other regulated landlords to allocate and manage affordable housing.

1.4 Conclusions

The findings of this extensive research on housing affordability for lower-income Australians reinforce and extend those of previous Australian studies in this field. Overall, they lend strong support to the case for establishing a national policy goal of improving housing affordability.

Under this national goal, well-coordinated action by all spheres of government (Commonwealth, state/territory and local) in four strategic areas is proposed, in order to tackle both the drivers and the consequences of a long-term decline in housing affordability in Australia.

1. The first set of actions should be directed at dampening the long-term trend of rising land and house prices by improving the efficiency of the housing market. Particular attention should be given to reducing impediments to housing supply in desirable metropolitan and regional locations, improving the efficiency of the residential development process and reforming those tax settings that can impact adversely on the price of housing in particular market contexts, either by stimulating demand or by adding to costs.
2. There will be a continuing need to provide direct financial assistance (such as First Home Owners Grant, Commonwealth Rent Assistance and other forms of housing subsidy) to help lower-income renters, and aspirant and struggling home buyers. This assistance should be designed to be responsive to the diversity of circumstances of individual households experiencing housing affordability problems. Careful targeting of this assistance is also essential, to minimise adverse price effects.
3. A national policy, funding and delivery framework that is capable of securing substantial private investment in an additional supply of well-located affordable housing for rent and for sale will be required, in order to stimulate provision at the affordable end of the private market and to redress the decline in social housing provision.
4. Changes to the social housing system will be necessary to secure the viability of this existing source of low-cost housing and to better integrate existing service providers and assets into an expanded sector of affordable housing.

2 AFFORDABILITY TRENDS

The focus of this report is on housing affordability for lower-income households. In broad terms, housing affordability problems exist when housing costs (whether for rent or home purchase) absorb too great a proportion of household income. The question of what constitutes too great a proportion varies by income level, household type and tenure, but a simple 30/40 rule (based on costs at 30% of income and focusing on households in the bottom 40% of the income distribution adjusted for household size) provides a robust rule of thumb as a benchmark indicator of households likely to be at risk of problems associated with a lack of affordable housing (RP1, RP3). Regardless of the definition employed, housing affordability problems tend to increase whenever housing costs rise faster than incomes.

2.1 Market outcomes

Increases in house prices, interest rates and rents over the last few years provide a clear indication of why housing affordability has persisted as 21st century headline news. With every increase in interest rates, media attention turns to the impact on households with mortgage debt. With every release of quarterly house price data, it turns to the plight of aspirant home purchasers excluded from access to home ownership. Most of these aspirant purchasers have moderate incomes. Recent declines in vacancy rates and the risk that investors will leave the rental market and exacerbate past losses in low-rent stock have switched media attention to private renters, many of whom are lower-income households. This changing media attention highlights an unavoidable fact of housing markets: owner-occupied and rental markets are linked, as discussed further below.

2.1.1 *What has happened to affordability for purchasers?*

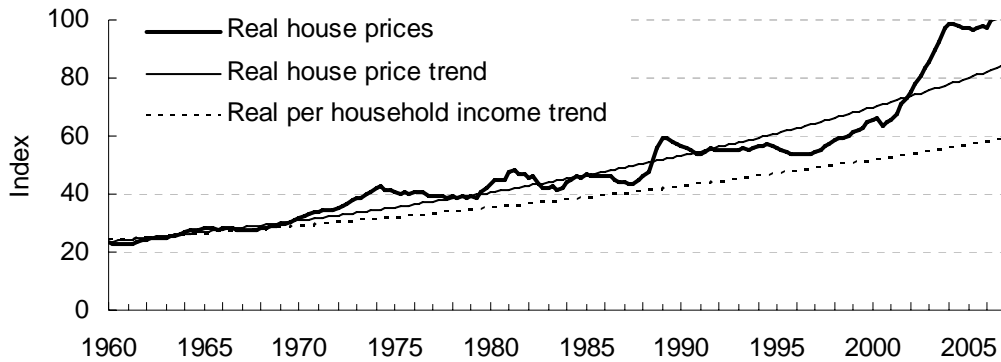
For purchasers, housing costs primarily depend on what happens to house prices and interest rates. While affordability problems can vary cyclically, house price and household income data suggest that there has been an underlying structural affordability problem in Australia over the past half century. Between 1960 and 2006 real house prices increased at an average of 2.7 per annum, ahead of a 1.9 per cent per annum growth in per household real incomes.³

This growth in real house prices can be attributed to the combined effect of the growth in per household real incomes, growth in the number of households, and deregulation of the finance system, which facilitated the translation of housing aspirations into housing demand. This increase in housing demand has put additional pressure on land supply that is already severely constrained by the urban settlement pattern of Australia, with more than half of all households located in the three largest cities. Because both demand pressures and constraints on supply show considerable spatial variation within and between regions, general trends based on Australia-wide averages are only indicative of overall pressures rather than providing precise indicators for any specific location. Spatial variation in outcomes provides even more compelling concerns regarding affordability, particularly in high-cost regions. (RP3)

The rapid increase in real house prices since 2000 (to the extent that the gap between prices and incomes has never been so wide) has been attributed to the combined impact of declining interest rates and the increased availability of mortgage finance (enhanced by the emergence of new mortgage instruments). These have encouraged both owner-occupiers and investors to increase their expenditure on housing, with the latter being further encouraged by negative gearing tax provisions and the 1999 change in the capital gains tax regime. The question of whether this post-2000

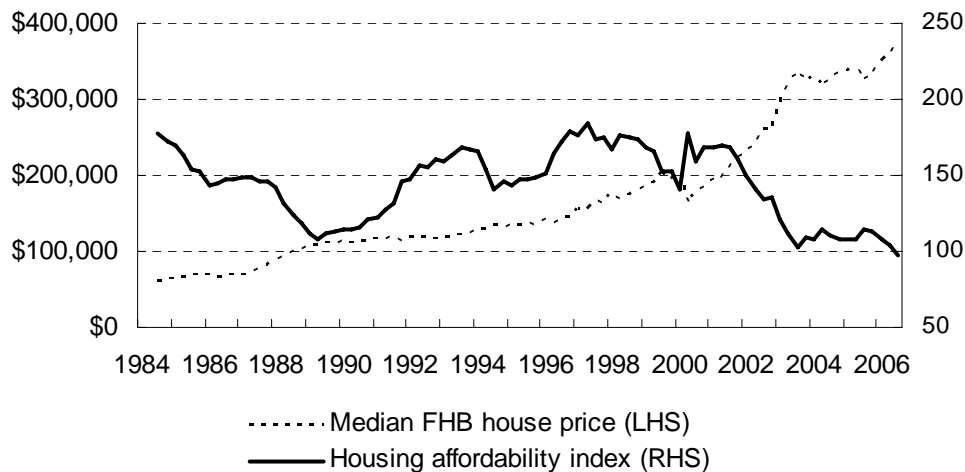
increase will be sustained has yet to be answered. However, continued growth in per household income and in the number of households, as presumed in the latest Intergenerational Report (IGR)⁴, will sustain the pressures that have led to the underlying trend increases, albeit at a marginally slower rate. (RP11)

Figure 2.1: Real house prices and income trends in Australia: 1960–2006



The interaction of house prices, incomes and the cost of mortgage finance, together with personal savings and deposit assistance, affect the ability of potential first home buyers to access home ownership. A number of conventional housing measures are employed to indicate how affordability changes as the relationship between these variables changes. One popular index for the period from 1984 (Figure 2.2) is that derived by HIA in conjunction with the Commonwealth Bank and based on first home buyer data.⁵

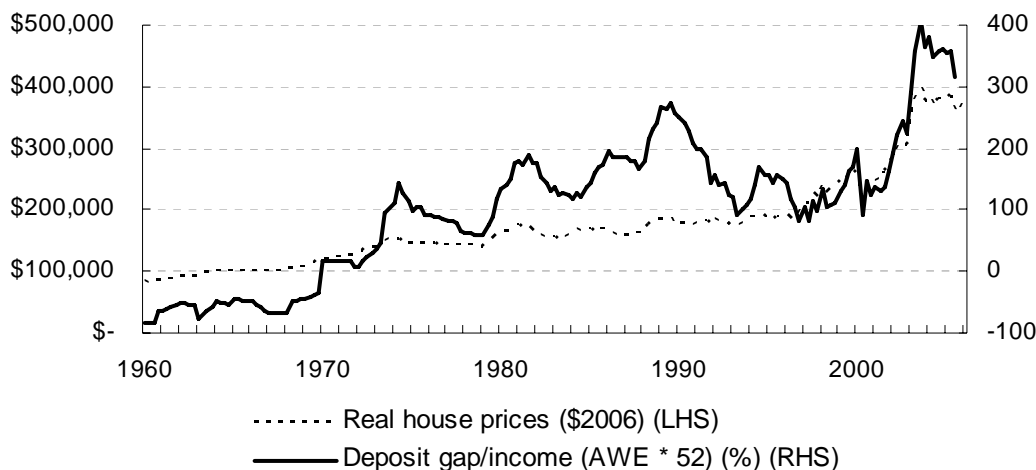
Figure 2.2: HIA housing affordability index, Australia: 1984–2006



This index highlights the cyclical nature of affordability outcomes and clearly shows the impact of rising interest rates in the late 1980s and early 2000s. However, it provides relatively little indication of the underlying structural problem that might be expected when the growth in real house prices persistently exceeds the growth in real household incomes. This is primarily because the index hides the doubling of the qualifying real household income needed to purchase a median first home buyer house over the period. In 1984, when the series began, the qualifying income was \$45,000 (measured in 2006 dollars). In 2006, it was \$93,000.

The existence of a structural problem can be observed more clearly from an alternative affordability index (Figure 2.3). (RP10) This deposit gap index examines the deposit that a household on the annual equivalent of average weekly earnings (AWE) (later average weekly ordinary time earnings) for a male in full-time employment would need to be able to purchase a dwelling with a price equal to the Australia-wide median.

Figure 2.3: Deposit gap affordability index, Australia: 1984–2006



Prior to 1970, a household on AWE had more than sufficient income to purchase a median-priced house. During the 1970s, the loan that such a household could afford needed to be supplemented with a deposit of up to twice the household's annual income. By the early 2000s, the loan the household could afford needed to be supplemented with a deposit of three or four times its annual income. While this deposit constraint on access to housing for households on average earnings has varied cyclically in response to variations in house prices and interest rates, there has been a general upward trend in the affordability problems faced by potential first home buyers on incomes equal to AWE (which were equivalent to a gross household income of approximately \$50,000 pa in 2006).

There are several potential effects of increasing affordability constraints on access to home purchase for potential first home buyers.

- Would-be purchasers can be discouraged from entering home ownership. This is reflected in the declining home ownership rates among younger households that have been observed since the 1970s.
- The income required for entry into home ownership increases, with the result that many single-income households are unable to access home ownership: this is exacerbated by lifestyle changes leading to later partnering.
- Both marginal and intra-marginal purchasers undertake larger loans with higher repayment to income ratios (facilitated in the past decade by liberalisation of lending requirements).

Only the last of these effects is likely to show up in aggregate affordability measures. Although the mortgage debt servicing ratio for households has exhibited an upward trend since the mid-1970s, much of this increase can be attributed to borrowers who can afford the repayments on higher loans. More detail on the implications of these trends is provided in RP10.

2.1.2 What are the implications for private renters?

Low-income renters are the largest group of households experiencing an affordability problem. (RP3) For many of these households, home ownership is not something they can even aspire to. (RP9)

The difficulties faced by low-income renters are likely to be compounded by discouraged purchasers who remain in the private rental market and by lifestyle renters who can afford home ownership but currently choose not to become home owners. Such households have the potential to place increased pressures on the private rental market, particularly when vacancy rates are low. Survey data show that average real rents paid by renters have trended upwards over the past decade at 1.25% per annum despite there being little evidence of this in the rent component of the CPI.⁶ One explanation is that the CPI rent data, as a price index, do not take into account quality and quantity changes reflected in actual rents paid.

While there is relatively little evidence of upward pressure on rents in aggregate CPI data, there is evidence from the 1986, 1996 and 2001 censuses to show that there has been an upward shift in the distribution of rental stock towards higher-rent properties and that higher-income households have displaced lower-income households from more affordable housing in the private rental market. There is also evidence to indicate that an increasing proportion of the low-rent dwellings that remain are either in non-metropolitan regions or in the outer regions of the larger cities.⁷

Relative stability in real rents (with implied declining rental yields as house prices increase) can be attributed to a number of factors. For example:

- Investors are willing to accept low rental yields in return for capital gains.
- Investment in rental dwellings has been dominated by relatively unsophisticated investors who had few alternatives for long-term saving. This explanation is likely to be more relevant in the past than the present.

The tax changes in 1999 are likely to have encouraged more sophisticated investors into residential rental investment, with the ability to gear their investment being a driving force. More recently, changes in superannuation policies and simpler cost-effective ways of accessing the share market have provided readily available alternatives to investment in rental housing. All of these trends raise questions as to whether real rents in the future will remain as low as they have in the past.

Although renters and owners are not affected in the same way by changes in housing markets, the home ownership and rental markets are closely linked, and factors affecting one ultimately will have an impact on the other. This is particularly so in Australia, where 95 per cent of dwellings are privately owned and where there are no restrictions on the movement of dwelling stock from rental into owner-occupation (or vice versa).

2.2 Affordability outcomes

One outcome of all these trends is that average housing cost ratios across all households have increased slowly but steadily from 11.4 per cent of gross household income in 1975-76 to 15.1 per cent in 2003-04. (RP3) Housing cost ratios for private renters have increased from 13.2 per cent in 1975-76 to 19 per cent in 2003-04.

Figure 2.4: Average housing cost ratios, Australia: 1975-6 to 2003-2004



Given the general upward trend in average housing cost ratios, an apparently surprising outcome is that the proportion of households paying at least 30 per cent of their income in meeting their housing costs (more than double the Australia-wide average) has remained relatively stable, varying only between 14 and 16 per cent over the last decade. The key explanation for the stability lies in the aggregation process, with increases in housing cost ratios for some households being offset by decreases for others. (RP8)

2.3 Drivers of affordability trends

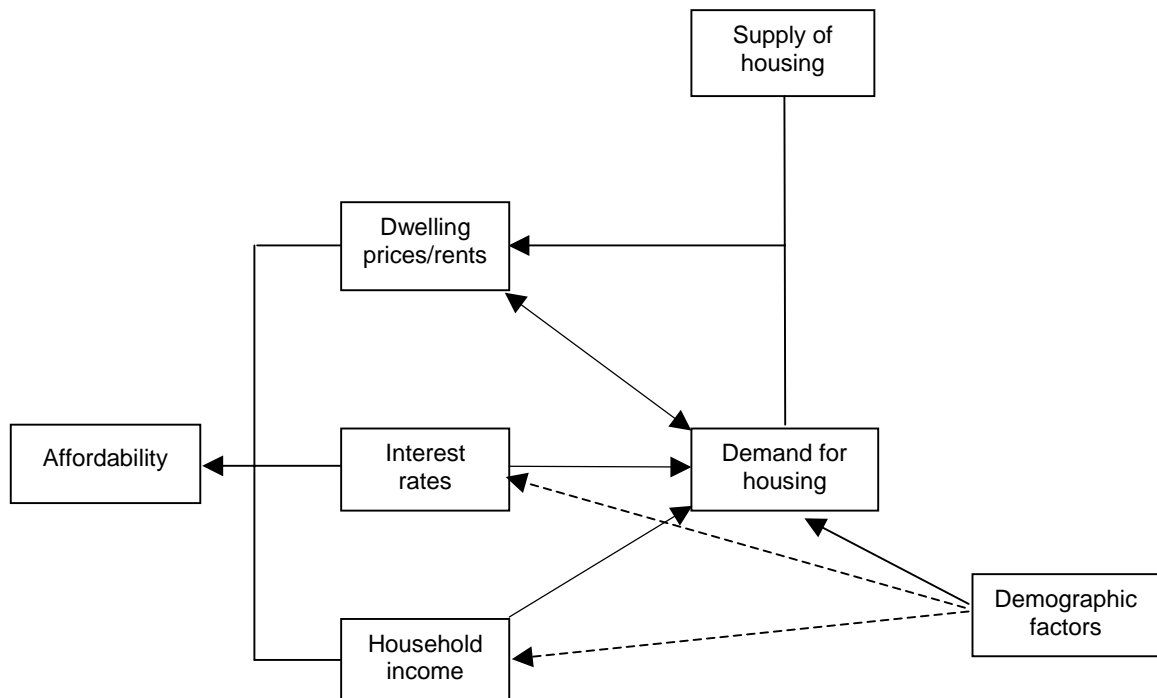
The research undertaken by NRV3 has produced a significant amount of evidence on the extent of current affordability problems and the factors that contribute to these problems. Much of this is reported in more detail in the following chapters. The aggregate results presented here suggest that these problems have been ongoing, with their origins embedded in the way in which housing markets operate and in the pressures that income and household growth have imposed upon them.

2.3.1 Structural factors affecting affordability outcomes

Key determinants of housing affordability outcomes and the interactions between them are illustrated in Figure 2.5. A myriad of factors influence these determinants of housing affordability. On the demand side, these include: household growth (in turn, affected by natural increase, immigration, household formation); real incomes; real wealth; tax concessions to both owner-occupied and rental housing; concessions to first home buyers; returns on alternative investments; cost and availability of finance for housing; and the institutional structure affecting housing finance provision. On the supply side, these include factors that affect the cost of provision, such as: the availability of land; land development processes and policies; infrastructure costs (including development charges); the cost of construction; and property-related taxes.⁸

Because housing is long-lasting, housing markets are inherently slow to adjust to changed circumstances. This contributes to a strong cyclical pattern that is superimposed on underlying structural trends.

Figure 2.5: Determinants of housing affordability



2.3.2 Risk factors that can affect affordability outcomes

In addition to the underlying structural issues affecting housing affordability, which have been the focus of this chapter, a number of relatively recent changes have taken place that increase the systemic risk that affordability problems may be even greater in the future than they have been in the past, particularly for lower-income households. These relate to the greater flexibility that has been the hallmark of the new economy and to the economic, social and structural changes that have been associated with it.⁹

- Labour markets are less regulated than they were in the past. There is greater reliance on fixed-term contracts, part-time work and a casualised workforce, all of which put incomes of the working poor at risk. The steady growth experienced over the past decade has provided a strong element of protection against the risks that such changes impose on individual workers but there is no guarantee that the economic boom will continue or that it will continue to benefit all workers, including the low-skilled. A downturn will affect purchasers who depend on overtime or additional part-time work to pay their mortgage and aspirant purchasers who rely on this to help save a deposit.
- Structural change has contributed to a reduction in the high rates of inflation and an associated nominal wage growth that dominated the economic environment in the 1970s and 1980s. In turn, this means that marginal home purchasers undertaking mortgages at the limit of what they can afford no longer can rely on inflation to reduce their repayment burden.
- Household relationships are more flexible than they have been in the past and single-person households are becoming increasingly dominant. Any transition from a household with more than one income earner to one with one or no earners increases the risk that contractual housing costs will become unaffordable. Transactions costs can make it difficult for households to adjust to changed circumstances.

- Part of the rise in single person households is associated with the ageing of the population. Demographic change creates the additional risk that the existing dwelling stock does not reflect the needs of smaller and older households in relation to both form and location. Mismatches between what is appropriate and what is available can contribute to affordability pressures if households are unable to choose the type of housing that best suits their current needs. The ageing of the population brings with it a further risk associated with the pressures that arise if the current generation of workers are not outright owners by the time they reach retirement age.
- The move from collective to individualised provision for retirement incomes via contributory superannuation schemes where payouts depend on fund earnings means households bear the risk of their retirement incomes being inadequate to meet both their housing and non-housing needs. Households constrained from gaining access to owner-occupation face the risk of higher housing costs in their retirement years than those faced by previous generations of retirees for whom home ownership has provided considerable protection from housing stress.
- Tax incentives designed to encourage personal superannuation benefit high-income and high-wealth households and run the risk of creating an economy in which income and wealth are even more unevenly distributed than at present. Such inequalities may impose greater pressures on the housing market than have been felt in the past and create additional affordability problems for those whose incomes and wealth have not kept pace with the national average.
- Incentives designed to encourage investment in superannuation may also have the unintended consequence of reducing individual investment in the private rental market. Any reduction in such investment either will add to pressures on rents or will result in a reduction in the supply of rental dwellings at a time when an increasing proportion of the population are being discouraged from entering home ownership for either lifestyle or affordability reasons.
- More generally, moves from collective to individual responsibility for health, education and retirement provision, to name just a few of the services that were centrally provided in the past, have meant that households face increased demands on budgets already squeezed by rising housing costs.
- Lower-income households seeking to avoid the burdens imposed by high housing cost ratios are forced to relocate to regions where housing costs are lower and where, in many cases, there is a general lack of services and where they may lose the support provided by family and community networks.

2.3.3 Summary

The overview in this chapter has pointed to broad trends in housing markets that have contributed to a persistent increase in the average housing cost burden borne by Australian households over the past three decades. It has also pointed to the additional risks that may add to housing cost burdens in the future. These trends and risks have contributed to the housing affordability problems faced by lower-income households. The characteristics of households most affected by worsening housing affordability and the ways in which they are affected are described in Chapters 3 and 4. These chapters highlight the reason for concerns regarding the impact of poor housing affordability on the households directly affected by it.

Considering effects on individual households, however, tells only part of the story of why poor housing affordability is a problem. The broader reasons for concern regarding these effects are covered in Chapter 4.

These broader reasons for concern arise because declining affordability also has an impact on the economy as a whole. The factors that contribute to increasing housing affordability problems can influence the broader economy through the interactions of movements in housing prices and change in aggregate demand. Housing affordability problems also can be a concern because of their potential impact on urban labour markets. For example:

- When the Reserve Bank raises interest rates to ease pressures in an over-heated housing market, there is a risk that households will cut back on consumption and that the economy will slow down. As incomes fall, housing stress further intensifies unless housing costs also fall proportionately. However, recent home purchasers and investors are locked into the preceding higher price regime and rents may not fall quickly or far enough to offset falling incomes and employment, especially in the low-cost private rental sector. Increasing housing stress in the declining phase of the cycle reinforces the negative effects on consumption, particularly when low- and moderate-income households are carrying large debts as a legacy of the preceding boom.
- Affordability problems can also mean that urban labour markets under-perform when there is frictional unemployment – which can occur when workers are unable to get and keep a job due to locational and access problems.

3 WHO IS AT RISK AND HOW DOES IT AFFECT THEM?

Much of the research undertaken for the NRV3 focused on identifying households that face unacceptably and unsustainably high housing costs in relation to their household incomes, and on determining how they are affected. This chapter covers research reported in more detail in RP1, RP3, RP6, RP9 and RP10. It indicates the extent of potential affordability problems, identifies households at risk and describes how housing affordability problems are manifest. The evidence generated provides a clear rationale for why housing affordability is a concern. A further rationale is provided by consideration of the likelihood that affordability problems will continue and of the impact that poor affordability outcomes have on society as a whole. This complementary evidence is covered in the following chapter.

3.1 How big is the problem?

3.1.1 Measurement issues

Determining just how much can be spent on housing costs before such costs impose an unacceptable and unsustainable burden on the household is contestable, not least because a household's ability to bear the burden of high housing costs is affected by a complex array of factors. (RP1) Foremost among these is household income. The complex array of demands made upon the budgets of a diverse range of households comes a close second.

High housing costs in relation to income are less likely to leave high-income households with inadequate resources to meet their non-housing needs than is the case for lower-income households. They are also more likely to reflect choices made by the households incurring them. An obvious example of over-consumption of housing among higher-income households is the increased demand for 'McMansions'. In such cases, the impact of high housing costs on individual households is of relatively little concern, although the impact they have in creating pressures on the housing market and the environmental impact of excessive consumption of housing may well contribute to broader concerns about affordability (covered in the following chapter).

High housing costs experienced by lower-income households are more problematic for a number of reasons. First, it is more difficult to determine whether high housing costs reflect a choice on the part of the household or whether the high housing costs arise because there is no alternative. Costs associated with choice might arise if a lower-income household chooses to purchase rather than rent or to live in a high-cost location rather than in a location where housing is more affordable. Costs associated with constraint might arise because of the household's need to live close to work or transport or simply because there is no housing available that is both affordable and adequate for their needs. Secondly, housing costs might be high in relation to income simply because income is too low. Thirdly, the question of whether a household will have adequate resources to meet non-housing needs after paying for their housing costs will depend on household type and size, as well as household circumstances. (RP1, RP3)

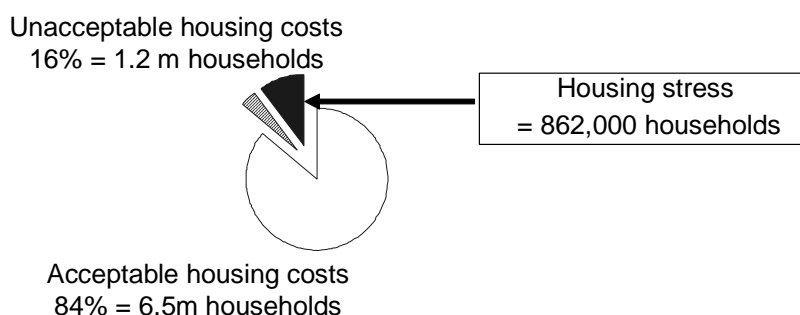
This chapter uses the 30/40 rule to indicate how many and which households are in housing stress and, therefore, at risk of experiencing housing affordability problems. It uses both quantitative and qualitative data to indicate what these affordability problems are and to provide estimates of the numbers and characteristics of households that actually experience them.

3.1.2 Housing stress estimates

The 30/40 benchmark was selected as a robust indicator of the potential scale of affordability problems. NRV3 research on alternative measures showed that it was also a conservative measure with a tendency to under-estimate rather than over-estimate the extent of the problem. (RP3) It is also conservative for a second reason. It takes no account of households whose housing cost burden is below 30 per cent but who live in housing which may be inadequate because it is overcrowded, of a standard below community norms, or located far from work, transport, services and family or other social networks. Such households are also likely to experience hardship as a result of poor housing affordability even though they are not included in the indicators reported here. A housing cost ratio of 30 per cent of income is more than double the Australia-wide average (of 15 percent).

- In 2002-03, the latest year for which data were available when this research was undertaken, of the 7.6 million households in Australia, just under 1.2 million (16 per cent of all households) paid 30 per cent or more of gross household income in meeting their housing costs.¹⁰ Of these, 862,000 were lower-income households, defined as being in housing stress. A further 164,000 were moderate-income households. (RP3)

Figure 3.1: Proportion of households with unacceptably high housing cost ratios



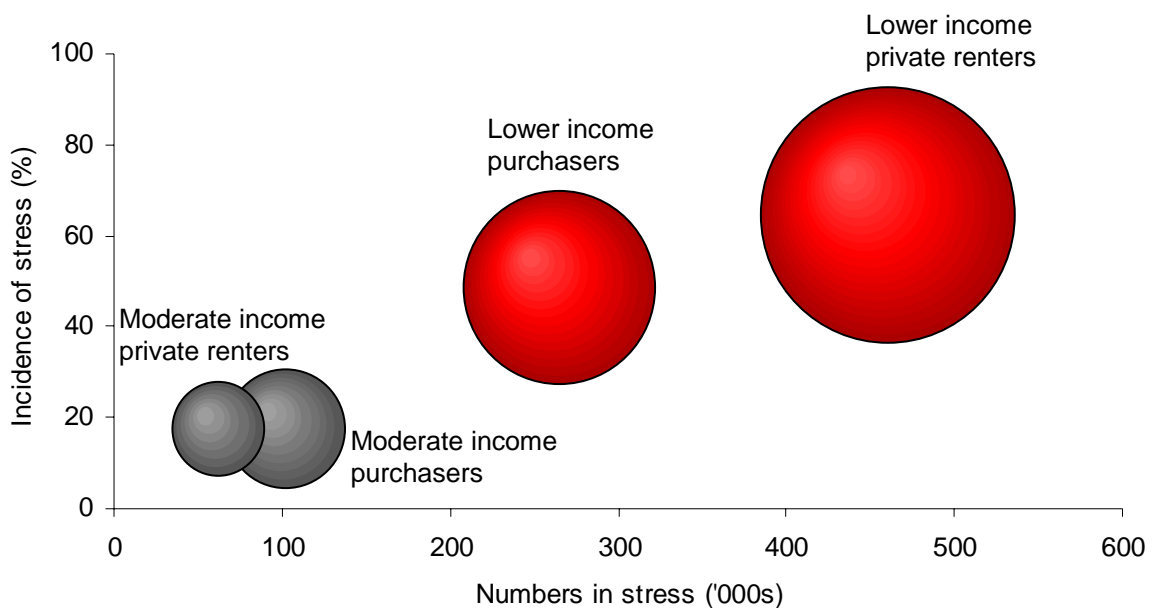
- This proportion has remained remarkably stable for the past 10 years despite the obvious price pressures in housing markets highlighted in Chapter 2. (RP3) There are a number of reasons for this. Households make trade-offs to avoid increasing the proportion of their income spent in housing. For younger households, these can include renting instead of buying, remaining for longer in the parental home, sharing instead of forming independent households. Older households who are established home owners are less likely to have their housing costs affected by housing market changes.
- A critical explanation, however, is that the aggregate measure disguises considerable variation in the incidence of housing stress at a disaggregate level. (RP8) The proportion of households with high housing costs in relation to their income is polarised and polarising.

3.2 Who is at risk?

Despite the relative stability of the proportion of those with high housing costs, there are several important concerns regarding observed housing affordability outcomes. These concerns include the following:

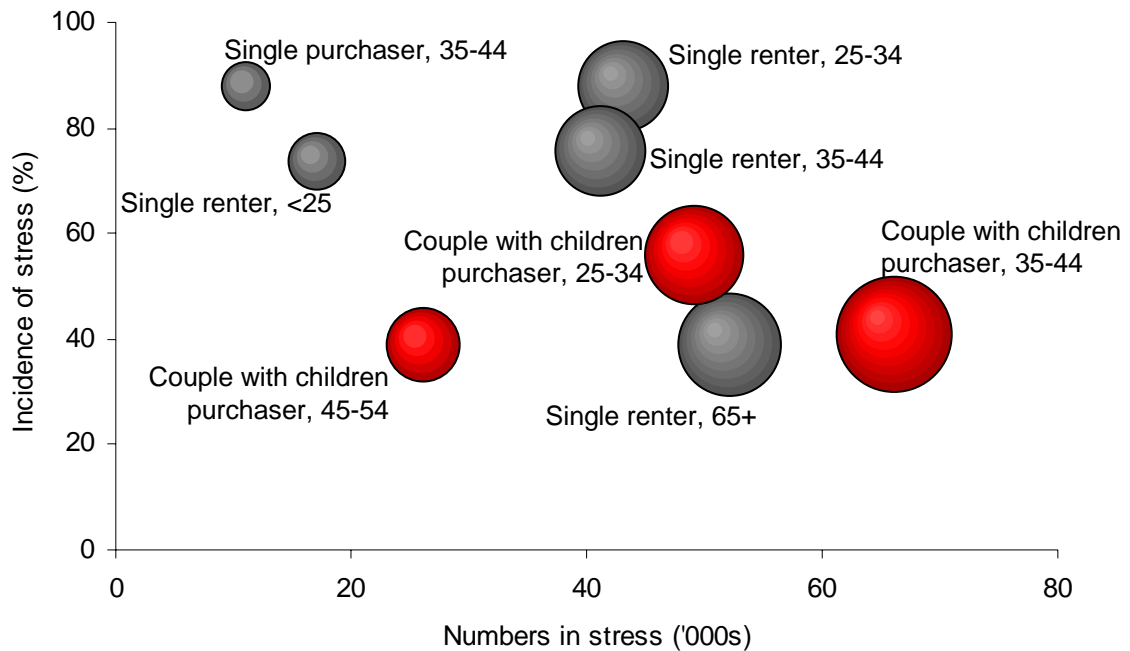
- The burden of high housing costs is not borne equally by all households. While 16 per cent of all households had high housing cost ratios, over 28 per cent of lower-income households were in housing stress. For particular types of households, the incidence was even higher. For example, the incidence of stress for private renters was 65 per cent. For purchasers the incidence of stress was 49 per cent. (RP3) The numbers and incidence of stress for broad groups can be seen in Figure 3.2, with the scale and incidence of affordability problems increasing from bottom left to top right and with the size of the problem mirrored in the size of the bubble.

Figure 3.2: Numbers and incidence of households at risk



- In the lowest two quintiles, the greatest numbers in housing stress are private renters, working households and households with children (both couple and sole parent households).¹¹ The incidence of housing stress is highest for lower-income private renters, single-person households aged less than 65 years and lower-income home purchasers. Almost half of lower-income households in stress are working households and over one-third of lower-income working households are in housing stress. These more detailed estimates for lower-income households are illustrated in Figure 3.3. (RP3)
- By 2045, the incidence of stress is projected to have increased for all of these households (by 4 percentage points for all lower-income households and by as much as 13 percentage points for private renters and 10 percentage points for sole parents). (RP11)

Figure 3.3: Characteristics of selected lower-income households at risk



- Stress is an enduring problem for many. There is close to a 50 per cent chance that a person living in a household in housing stress in one year will be living in a household in stress in the following year and a 60 per cent chance that they will be living in a household in stress for one of the next two years. (RP3)
- In a decade, the proportion of households in housing stress increased from 24 per cent in the mid-1990s to 28 per cent in 2002-03. This was a period when there was steady economic growth and an increase in average household incomes, including those of lower-income households.¹² (RP8)
- The total numbers paying a higher proportion of their incomes in meeting their housing costs has steadily increased as the number of households in Australia has increased. (RP3)
- Under a reasonably conservative set of assumptions about future trends, both the incidence of housing stress and the total numbers in housing stress are likely to increase. By 2045, broadly the period covered by the government's two Intergenerational Reports, there are likely to be at least half a million more households in housing stress than at present, increasing the number of lower-income households at risk of facing significant affordability problems to well over 1.5 million households.¹³ (RP11)

This increase in numbers arises because of the projected increase in the number of households into the future, the ageing of the population, a projected increase in the proportion of households in private rental housing and the higher incidence of housing stress among households in private rental.

- The incidence of housing stress is also expected to increase as demographic change interacts with tenure change. This anticipated increase in the incidence of housing stress is particularly significant for lower-income households in the private rental market as the impact of (i) the current decline in home ownership rates among younger households and (ii) the contraction of the public housing sector work their way through the system. (RP11)

- The polarisation of affordability housing stress (RP8) is anticipated to worsen by 2045, with an increasing proportion of lower-income households – both young and old – in the private rental market. (RP11)

3.3 How does it affect them?

The estimates presented above identify households potentially at risk of problems arising directly from unacceptably high costs. However, they do not provide any indication of what these problems might be. These implications are covered here. Unless indicated to the contrary, all of these results are taken from RP9.

Housing affordability problems are assumed to arise when households are forced into decisions that adversely affect them and which would not have been made had they not been in housing stress. While some of the experiences are shared across tenures, some are specific to private renters and others are specific to recent purchasers.

Common experiences include:

- Facing the constant stress of not having enough money to cover rent or mortgage payments and other necessities of life, particularly utility costs. Living with constant stress contributes to health problems, as well as placing stress on family relationships.
- An increased probability of financial hardship. (RP6, RP9) This can result in households going without meals, their children missing out on school activities and adequate health and dental care, or in having to pawn possessions for financial viability.

Experiences for stressed renters include:

- The risk of being stigmatised with poor credit histories because of rental arrears
- Being forced into frequent moves in their search for affordable rental housing. This brings with it dislocation and significant search costs, particularly when there few vacancies in the low-rent segment of the market.
- Making trade-offs regarding dwelling quality and location which affect their access to employment, education and health services
- Having their future aspirations for ownership blocked
- Fearing that there will be no relief from this stress in the foreseeable future.

Experiences for stressed recent purchasers include:

- Fearing that an interest rate rise will mean they may not be able to meet mortgage repayments and be pushed into foreclosure
- Fearing that loss of employment, part-time work or overtime will mean they may not be able to meet mortgage repayments and be pushed into foreclosure
- For those on high loan to valuation ratios, fearing that any downturn in finances will put them in a position of negative equity
- Being unable to undertake essential repairs to their dwelling or to furnish the home appropriately
- Fearing that they have no reserves (in the form of savings) to tide them over any change in circumstances.

Many stressed renters (particularly those defined below as strugglers or backsliders) report that they are unlikely to benefit from intergenerational transfers that might help them gain access to owner-occupation to provide them with long-term relief of their

affordability problems. This is in marked contrast with higher-income renters surveyed, for whom housing stress is a pragmatic choice and one that creates relatively few problems.

As renters excluded from home ownership reach retirement age, their incidence of housing stress is likely to increase, as are the problems they face as a result of their poor affordability outcomes. (RP11)

The dynamic effects of affordability problems faced by lower-income households are also relevant. Many of the renters surveyed reported that:

- They are unlikely to ever achieve home ownership because their current incomes are too low and unstable and they feel it is unlikely that they will ever get a job that will pay them an income sufficient to change this.
- They had low rates of satisfaction with their current dwelling and a perception of intergenerational inequity in that they regarded their housing situation as being worse than that of their parents.

These results highlight the extent to which poor housing affordability outcomes can exacerbate the already significant inequalities that arise from housing market outcomes. (RP10)

Stressed lower-income home purchasers face fewer problems. Proportionally, the greatest difficulties arise for those faced with ongoing costs associated with home-ownership such as unexpected maintenance costs that were not budgeted for. Unlike renters facing high housing cost burdens, however, many home purchasers are able to adjust the timing of these housing costs so that they have less of an impact on non-housing outcomes.

There are, however, a small minority of stressed purchasers who face similar housing affordability problems as those experienced by stressed renters. There are more who face the prospect of loss of their family home if their economic or personal circumstances change.

3.4 From housing stress to housing affordability problems

Not all households in housing stress experience the types of problems indicated in the previous section. One reason is that some households have made a conscious decision to spend more than 30 per cent of their income on housing because they feel they can afford to do so. Another reason is that the simple 30/40 measure does not capture the extent to which many households are paying considerably more than 30 per cent. For example, of the 862,000 lower income households identified as being in stress, over 400,000 were paying more than 50 per cent of their income for housing. (RP3) Lower income households with extremely high housing cost ratios are more likely to experience affordability problems than higher income households with similar housing cost ratios because they have so little disposable income remaining after they pay for their housing.

Supplementary quantitative and qualitative research on households in housing stress undertaken for the NRV provides the key to identifying which households are likely to be adversely affected by their high housing costs. This section reports on the insights gained from this research.

This supplementary research was undertaken, very specifically, in the kinds of suburbs and regional cities in which most low- and moderate-income Australians live. Details are provided in RP9.

3.4.1 Taxonomy of households at risk

Through the surveys, focus groups and interviews, a breadth of experiences, contexts and outcomes across both renters and recent purchasers was identified. While these are diverse and cut across the specific socio-demographic and economic characteristics conventionally used to describe households most likely to be in housing stress, they are consistent with the broader understanding obtained by more conventional classifications. They also serve the important role of reiterating the observation that not all lower-income Australian households in housing stress are struggling and discontented in the private rental market, and not all are finding it impossible to overcome significant barriers to home ownership.

In all, seven archetypes have been identified.¹⁴ A broad indication of the extent to which these were represented among those surveyed is provided in percentage terms. (RP9) Indicative lower bound estimates of the total numbers involved at a national level are provided in parentheses. While the survey covered a range of households, the numbers cover only households in housing stress.

For renters, the four groups identified are described as:

- Strugglers – 30% (approx 140,000 nationally)
- Backsliders – 10% (approx 46,000 nationally)
- Pragmatists – 30% (approx 140,000 nationally)
- Aspirant purchasers – 30% (approx 140,000 nationally)

Strugglers are those who are having trouble meeting rental payments and who are suffering high levels of financial stress. They can be of any age group, but are often single or in lone-parent households. They are often not working. Despite living in cheaper locations, they are often paying extremely high proportions of their incomes towards housing (up to 50 or 60 per cent). Strugglers were often found in neighbourhoods generally regarded as 'affordable' or in those where house price increases had put pressures on rents. They represent the core group of long-term renters.

Backsliders are those who at an earlier stage in life had once owned their own home. They have 'fallen out' of home ownership, usually as a result of a major rupture in life circumstances such as a loss of earning capacity, health difficulties or in household circumstances either as a result of loss of a partner through death or relationship breakdown. Backsliders often sought to retain ties to a particular neighbourhood and had problems in achieving this. Returning to rental compounds the sense of loss and strain imposed on this group by their change in circumstances. They need to restart their lives but lack 'renter knowledge' and the skills required to negotiate the rental market.

Pragmatists are those who are generally managing and who perceive that there are benefits of renting as opposed to owning. Many of those surveyed were paying relatively high proportions of their income towards housing, but were doing so as a result of trade-offs made to reflect lifestyle and family choices. Pragmatists were more prevalent in markets that had been relatively stable with little upward pressure on rents. Many were reconciled to living with life's ups and downs.

Aspirant purchasers are those who still aspire to home ownership and believe that they are going to make it, although not all of those surveyed thought they would be able to do so in the short- to mid-term. A common characteristic of aspirant purchasers was full-time, secure employment and, typically, two incomes. Many of the older renters who still aspired to home ownership were beginning to recognise that

they were no closer to achieving this goal than they were 10 years earlier, and were exhibiting an increased sense of anxiety about the implications of remaining renters for the long-term.

Of these renter groups, it is the Strugglers and Backsliders who are of pressing policy concern in both the short and the long run. They can be regarded as being trapped in the private rental market and they face immediate housing affordability problems. Their circumstances also raise important questions about the long-term and the risks they are likely to face as they age, if they have not had the opportunity to build up property-based assets. The research reported in RP10 shows the huge divide in wealth ownership between those who own their own dwelling and those who do not. To the extent that their numbers are swelled by any increase in the number of Pragmatists or disillusioned Aspirant purchasers, these long-term concerns are compounded.

For purchasers, the three groups identified are described as:

- Stretched – 40% (approx 106,000 nationally)
- Focused – 20% (approx 23,000 nationally)
- Ambivalent – 40% (approx 106,000 nationally)

Stretched purchasers are those who had very little slack in their capacity to pay when they entered home purchase and are now expressing concerns about their ability to pay their mortgage.¹⁵ Many have young, growing families and had limited capacity to save before they purchased, which has meant that they have no buffer to cope with problems as they arise. They have been hit hard by the interest rate increases that took place prior to being surveyed and they have been forced into a range of management strategies because of budgetary constraints. For example, they have worked longer hours or taken on a second job, with the resultant pressures on family life. They are concerned about the risks to their income if the labour market softens. Others have not managed. They have increased their mortgage in order to release funds to accommodate increased interest rates, or have had to approach welfare agencies. In broad terms, they have limited equity in their property, having bought with minimal or no deposit. A significant proportion of these purchasers have been unable to meet their repayments at some time in the past year. Stretched and Focused recent purchasers were more likely to be found in the outer metropolitan regions where rising interest rates and stagnating house prices have had the most impact.

Focused purchasers recognised that mortgaged home ownership is a significant life changing process that would impose compromises and constraints on their lifestyle. Although not struggling to meet repayments, a number were paying upward of 50 to 60 per cent of their income to pay off their mortgages. For a significant group, this overpayment was a clear strategy to pay off the mortgage as quickly as possible. Despite their belief that home ownership should provide them with long-term security and despite their risk management strategies to increase the probability that this would be so, many were insecure and feared that their homes were at risk. This led them to work more overtime than they wished, to compromise family happiness and to scrape by on hermit-like lifestyles.

Ambivalent purchasers are those who are not necessarily committed to home ownership. They ended up purchasing because it seemed the right thing to do at the time or because on balance it appeared to provide them with a more cost-effective option than continuing to rent. For some, it was a result of peer pressure or a sense

of being left behind. Among these purchasers were those who had a realistic assessment of the advantages and disadvantages of both renting and owning.

Of these purchaser groups, it is only the small core (around 5–10 per cent) of Stretched purchasers who are not coping who are of pressing policy concern in the short term. However, the highly constrained lifestyles of the Focused purchasers highlights potential concerns about the long-term risks that access to home ownership presents in an environment where financial market and labour market flexibility have become the norm. For many this means that home ownership, instead of being a symbol of security and stability, has become a risky undertaking contributing to a sense of insecurity.

3.4.2 Housing stress and housing affordability problems

The taxonomy presented above and the estimates of proportions in the various classifications were derived from the quantitative and qualitative surveys undertaken for NRV3 (described in RP9). Table 3.1 synthesises some of the quantitative and qualitative results from these surveys.

Table 3.1: Households-at-risk assessment

<i>Typology</i>	<i>Risk assessment</i>	<i>Normative measure: 30/40 rule</i>	<i>Subjective measure: feel stressed</i>	<i>Duration: long-term problems</i>
<i>Renters</i>				
Strugglers/ Backsliders	Affordability problems, no foreseeable way out	Yes	Yes	Yes
Pragmatists	Affordability problems, but short-term	Yes	Yes	Mixed
Aspirant purchasers	At risk of affordability problems	Yes	No	No
<i>Purchasers</i>				
Stretched	Affordability problems, no foreseeable way out	Yes	Yes	?
Focused	Affordability problems, but short-term	Yes	Yes	Mixed
Ambivalent	At risk of affordability problems	Yes	No	No

These surveys focused on locations where, according to census data, there are high proportions of stressed private renters and home purchasers. Although the surveys cannot claim to be representative, they do provide the basis for determining a lower bound estimate of the numbers of households in housing stress for whom housing affordability problems are a reality, not just a risk.¹⁶ This is the focus of this section. It provides indicative estimates of the extent to which housing stress leads to housing affordability problems.

The evidence reported in RP9 suggests that the 40 per cent of renters classified as trapped (made up of 30 per cent of Strugglers and 10 per cent Backsliders) experienced a number of the problems outlined in section 3.3. Their current housing circumstances, which they have experienced for some time and perceive as on going, causes them stress. In Table 3.1, they are described as having no foreseeable way out of the affordability problems that arise from their being in housing stress. In Figure 3.4 they are grouped with the small core of stretched purchasers (representing 5–

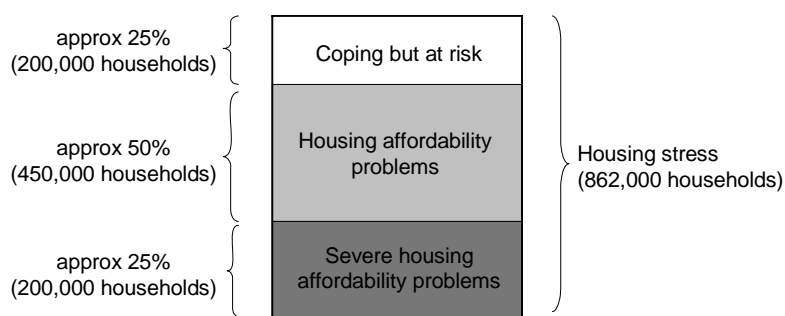
10per cent of those surveyed) as households with severe housing affordability problems and, therefore, of immediate policy concern.

The 30 per cent of Pragmatic renters are described in Table 3.1 as having short-term affordability problems. This is possibly a sanguine interpretation since their pragmatism often arises from a sense of resignation and from coming to terms with trade-offs they are forced to make. They are not in a position to save or to build assets. Because of the significant trade-offs they are forced to make in order to meet their high housing costs, Pragmatic renters and Focused purchasers are classified in Figure 3.4 as experiencing housing affordability problems.

The remaining households – the 30 per cent of renters who are Aspirant purchasers and the 40 per cent of purchasers who are Ambivalent – are described in Table 3.1 as being at risk of experiencing housing affordability problems. They are coping in that currently they are managing the stresses that high housing costs impose upon their limited budgets. They are, however, at risk of experiencing the types of affordability problems that are associated with having no discretionary income, no capacity to save and inadequate resources to meet unanticipated expenditures.

Figure 3.4 combines the qualitative data reported in RP9 and the quantitative data reported in RP3 to provide indicative estimates of the number of households in these three categories.¹⁷

Figure 3.4: Housing stress and housing affordability problems



The 200,000 or so households at the bottom of the figure are currently experiencing severe affordability problems. These are the trapped renters and a small proportion of stretched purchasers. The 450,000 in the middle group are households whose high housing costs force them into making trade-offs that place them under considerable strain. They, and the 200,000 households at the top of the table who are classified as coping, are at risk of experiencing severe housing affordability problems. They have a relatively fragile capacity to cope with any future changes that will affect their housing costs in relation to their capacity to pay. Examples of such changes are increases in interest rates or rents. A change in household circumstances is another example. Many of these changes are beyond their control.

A number of these risk factors were highlighted in Chapter 2. Their potential impact on households currently experiencing or on the threshold of a housing affordability problem are covered in the following chapter.

4 WHY IS HOUSING AFFORDABILITY IMPORTANT?

The results reported in the previous chapter provide evidence of the extent of the housing affordability problem and the range of effects on households. It concluded with the claim that the likelihood that households in housing stress will have an affordability problem is influenced by a number of factors. These were described in Chapter 2 as factors that increase the systemic risk that affordability problems will be greater in the future than they have been in the past. In the main, they relate to the greater flexibility that has been the hallmark of the new economy, and to the economic, social and structural changes that have been associated with these changes. This chapter examines the potential impact of some of these changes.

Before doing so, however, it presents a wider assessment of why housing affordability is important and why it should be viewed as a pressing policy concern.

4.1 Economic and social impact

Housing affordability is important not just because of the costs borne by the individual households experiencing high housing costs, but also because it imposes costs on the wider economy and society. The research undertaken by NRV3 focused primarily on the former, as many of the social outcomes were identified in the systematic review undertaken for NRV1.¹⁸ However, social outcomes identified by the research were reported in the previous chapter. For example, some of the coping strategies employed by those with housing affordability problems (such as frequent moves) can contribute to a lack of social cohesion. (RP9)

The economic costs that add to the wider explanations of why housing affordability is important are covered below. These add to the risks associated with failing to address the problems of affordability as they become increasingly oppressive.

Housing affordability potentially has an impact on economic outcomes in a number of ways. In the first place, it can affect the macro economy. In the second place, a lack of affordable housing may affect the efficiency with which labour markets operate at both a national and regional level, and particularly in the large metropolitan areas in Australia. Thirdly, it has a very significant impact on wealth distribution in our society and therefore can contribute to social and economic problems that flow from an inequitable distribution of resources. In other words, housing affordability affects the economy through its impact on stability, efficiency and equity.

4.1.1 *Impact on the macro economy*

Australia as a middle-ranking, open economy is vulnerable to interest and exchange rate shocks. The operation of the housing market impinges centrally on these parameters.

- Excessive debt burdens undertaken by home purchasers in response to high house prices can make households more sensitive to interest rate increases. To meet their increased mortgage payments, households may cut back on consumption, thus creating a potential for greater economic instability. (RP4)
- High house prices that render home ownership unaffordable for many first home purchasers add to housing wealth for existing home owners and can contribute to increased aggregate demand both directly and indirectly through providing the basis for equity withdrawal (which, in turn, adds to increased debt and to the threat of interest rate changes bringing about a severe credit squeeze). (RP4)
- High house prices may also contribute to inflationary pressures. (RP4)

All of these make it more difficult to manage the economy.

To the extent that intensifying housing stress increases the risk that house price movements will increase the overall volatility of the economy, problems of housing affordability should attract the attention of economic policy makers at the national level.

4.1.2 Impact on economic efficiency

A lack of affordable housing also can affect the efficiency with which labour markets operate at both national and regional levels, and particularly in the large metropolitan areas in Australia. There are a number of ways in which such outcomes might arise.

- High housing costs, for example, may be reflected in rising wage levels that feed back into rising housing prices in a region, although the precise nature of the causal processes are unclear. If pronounced, this can undercut the competitive advantage of firms locating in the region. (RP5)
- Differentials in affordability between areas may create labour market impediments by inhibiting migration to high-employment, high-cost locations and, conversely, encouraging migration to low-employment, low-cost areas. (RP5)

Both of these processes of labour mobility and immobility have the capacity to contribute to a spatial mismatch between jobs and workers, particularly in relation to the availability of lower-paid workers in high-cost global cities. They stem from imperfections in spatial housing markets and can hinder the emergence of an efficient spatial economy (that is, one where resources are used in ways that would maximise Australia's growth).

While the risks of spatial mismatch are very real, the evidence of the extent to which there is a mismatch in Australia arising from housing affordability problems remains inconclusive. It remains an open question as to whether or not a potentially mobile, mixed and uncertain supply of lower-paid, 'flexible' labour will adequately meet the functional needs of the globally oriented economy centred in the core areas of the major cities.

4.1.3 Impact on distributional equity

High housing costs and low affordability have their corollary in substantial increases in the asset levels of residential property owners and therefore a widening of the wealth distribution between them and the sizeable minority of non-residential property owners.

- Processes of gentrification that have pushed much affordable housing to the fringe of urban areas and regions have contributed to a tendency towards spatial polarisation. (RP5)
- Intergenerational equity is compromised by the increasing disparities between those who gain access to home ownership and those who do not as a result of the high cost of access to owner occupation. (RP10, RP11)

Increasing disparities in wealth add to the risks of a loss of social cohesion. Increasingly polarised cities foster defensive behaviours, not just by those in areas of deprivation, but also by more affluent citizens who may demand housing estates and building forms constructed on principles of safety and security (eg gated communities). This in turn can undermine a sense of wider citizenship as people retreat to, and structure a life around, their own small, gated world and ignore their broader social obligations.

In summary, the evidence presented in Chapter 3 and in this section of Chapter 4 provides a compelling case for suggesting that housing affordability is important because of:

- The known impact it has on individual households and the consequent risk it imposes on the achievement of social objectives
- The risks it imposes on achievement of broader economic goals of stability, efficiency and equity.

4.2 Risks

4.2.1 Risk as a motivation for concern over housing affordability

The evidence reviewed so far provides a rationale for why high housing stress is important and should be a matter for concern. It focuses on the risks associated with the outcomes of poor housing affordability.

Table 4.1 summarises some of the potential risks arising from possible future trends in relation to affordability outcomes. It focuses on possible outcomes for individual households in housing stress and at risk of facing resultant housing affordability problems (as identified in the typology presented in Chapter 3) and the economic and social system as a whole (as discussed in section 4.1).

Among the systemic risks identified, one key theme included in the table concerns the risk of increased social polarisation, a situation that might arise if increasing house prices and interest rate rises were to lock an increasing proportion of households out of the home ownership market (eg Aspirant purchasers). This in turn could lead to labour market pressures as these households relocate to other areas. If the social contract of access to home ownership for a large group of households disappears, the resultant social polarisation also could lead to increased friction between owners and non-owners. In turn, this might create a political problem for governments.

A second theme relates to the risk of economic destabilisation arising from the impact of economic change on purchaser households. In cases where there is a reasonably sharp increase in interest rates, there could be a tendency for home purchasers to struggle to retain their home. In addition to the obvious pain for households, this could also put pressure on financial institutions, particularly those institutions with large loan books of low-documentation loans.

A third theme focuses specifically on the impact on individual households. The NRV3 research points to a large body of trapped renters. This group would be particularly vulnerable to increases in rents. Their response to this may lead to increased churn in the rental market and a desire to seek cheaper housing on the fringe and, therefore, to additional financial and environmental costs of travel. Increases in fuel costs may also put more pressure on the financial situation of these low-income households.

Table 4.1: Risk assessment matrix

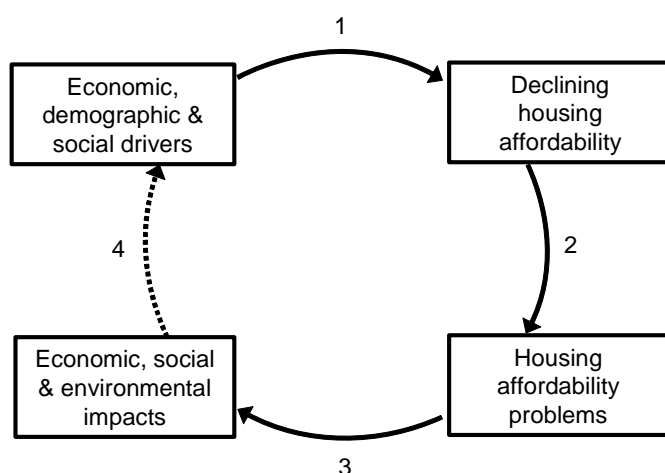
<i>Core group</i>	<i>Possible trend</i>	<i>Potential household risks</i>	<i>Societal and organisational risk</i>
Trapped renters	Increase in rents ahead of increases in income.	<ul style="list-style-type: none"> → Households move to remoter locations to find cheaper housing, leading to increase in length of commuting – this generates extra pressures on household budgets and family wellbeing. → Increases in homelessness and overcrowding. → Arrears, eviction and high mobility rate resulting in inability to integrate into community, high transaction costs for those who can least afford it, non-shelter outcomes especially affect on children’s schooling; financial pressures strain family relations. 	<ul style="list-style-type: none"> → Increasing greenhouse gas emissions. → Increasing social polarisation. → High mobility rates in specific locations can affect sustainability of areas, and create potential for polarisation between urban areas, reducing social cohesion.
Aspirant purchasers	Increase in rents ahead of increases in income and increase in house prices ahead of increases in incomes.	<ul style="list-style-type: none"> → Inability to save and bridge deposit gap. Creates blocked aspirations and household stress. 	<ul style="list-style-type: none"> → Frustrated potential owners creates political problem. Loss of faith in government and governance. → Weakens value of home ownership. Tension between purchasers and non-purchasers grows. → Puts pressure on retirement policy as housing costs absorb large proportion of retirement savings/income. Leads to increases in costs of supporting the aged. → Weakens value of home ownership and encourages consumption of other goods. → Cities with high barriers to home ownership become unpopular places for low- to middle-income groups. Labour market pressures and skill shortages increase.

<i>Core group</i>	<i>Possible trend</i>	<i>Potential household risks</i>	<i>Societal and organisational risk</i>
Stretched purchasers	Increase in house prices.	→ Households move to more distant locations to find cheaper housing, leading to increase in length of commuting – this generates extra pressures on household budgets and family well being.	→ Increasing greenhouse gas emissions. → Increasing social polarisation.
	Increase in interest rates.	→ Loss of homes for those with high levels of debt (but risks are balanced by very tenacious preferences for home ownership). → Severe reductions in consumption for those who remain in their home. → Reductions in disposable income affect family relations and non-shelter outcomes such as health and education.	→ Public loss of confidence in housing market (prices fall) and in financial system. Loss of general economic confidence as a result of loan failures. → Reductions in consumption put pressure on other sectors. → In extreme cases, some pressure on financial institutions carrying bad loans. → Households withdraw from community, affecting social capital.
	Increase in the divorce rate.	→ High debt level households depending on two incomes for repayments forced to sell property.	→ Financial pressures from increases in housing costs put extra pressure on social support systems.
	Increase in unemployment and loss of income.	→ Long period of economic growth – large numbers of home purchasers in particular have not been exposed to recession. A large number of mortgages depend on two incomes. High levels of debt make this a particular issue. →	→ Loss of economic confidence associated with loan failures.
	Expansion of unregulated finance sector with low doc loans, high LVRs.	→ Increased risk of loan failures resulting in high personal costs.	→ Loss of economic confidence associated with loan failures. Resentment about failure of governance.

4.2.2 The risk cycle

The risks illustrated in Table 4.1 highlight the reason that housing affordability should be seen as a major concern. The interconnectedness between the risks that economic and social change create for housing affordability outcomes (reflected in the housing stress measure employed in this report), the risk that housing stress exposes particular households to significant housing affordability problems and the risk that these problems have wider economic and social impacts provides an additional and compelling reason why housing affordability should be the focus of greater concern than is currently apparent. The potential for a vicious cycle of affordability problems to develop is illustrated in Figure 4.1.

Figure 4.1: The risk cycle



4.3 Challenges

The need to manage these risks and the risk cycle creates a challenge for policy. Policy can anticipate risks and can act either to prevent their cause or to reduce their magnitude. Alternatively, it can accept the risks and act curatively to ameliorate their effect.¹⁹ The challenges raised by these two options are covered briefly below. Principles and illustrative policies are covered in the final chapter.

4.3.1 Anticipation of risks

Anticipation of risk primarily involves intervention at point 1 of the cycle illustrated in Figure 4.1. This involves addressing the economic and social drivers that affect affordability outcomes. It would address the factors that contribute to declining housing affordability and housing stress.

It implies a set of policy actions that address interactions between the housing system and broader economic, social and environmental goals of government. To overcome declining affordability, policies that influence economic development and labour market functioning, fiscal and monetary settings, transport planning and infrastructure provision, population distribution and settlement planning, income support, and urban and regional sustainability need to be geared to helping address the deteriorating housing affordability problems identified in RP3, RP 4, RP5, RP6 and RP10. These broader policy challenges are not addressed specifically in this report, but a comprehensive overview of their impact on housing affordability can be found in the Productivity Commission report on First Home Ownership.²⁰

Such risk management through anticipation and prevention of risk is a challenge for government because it requires a long-term view.

4.3.2 Amelioration of the impact of risks

Amelioration of the impact of housing stress and the associated housing affordability problems that arise from the operation of the housing system are more likely to involve short-term as well as long-term approaches to policy. Such approaches address symptoms rather than the causes and primarily involve intervention at point 2 of the cycle illustrated in Figure 4.1.

Some of the challenges that such an approach might raise are covered below. Many of the key challenges arise because of the changing nature of housing affordability problems. They involve reconsideration of what, conventionally, have been regarded as housing policies. Some of the policy options that might be considered are covered in the following chapter.

4.4 The role of housing policy

The housing problems of households today are different from those of the past and the incidence and experience of housing affordability in Australia is changing in ways that are highly significant to individuals and society as a whole. The empirical findings presented in RP3 and RP9 show that those in housing stress include significant groups of:

- First home buyers on modest incomes (the 'Stretched') who have entered the housing market at a time of historically high house prices and who face an extended period of high housing outlays and indebtedness
- Households who are dropping out of home ownership after they experience an adverse change in their personal circumstances such as family breakdown, a change in employment, or ill health / disability (the Backsliders)
- Frustrated renters (the 'Aspirant purchasers') who have steady employment and strong aspirations to buy a home but are unable to do so because continuous increases in the price of housing have created too large a deposit gap for them
- Low-income renters (the 'Strugglers') with no capital assets who are unlikely ever to become home-owners. These renters represent the largest group in stress. If they remain housed under prevailing private rental market conditions and policies they will be denied access to housing security and housing wealth, as well as continuing to be in, or at risk of, housing stress.

To help understand the implications of these new realities, RP9 described how households in each of these main groups cope with housing situations that do not meet their needs and aspirations. It highlighted the trade-offs that overcommitted homebuyers make to meet their mortgage costs and the stressful and unhappy living situations endured by families who are struggling to make their regular mortgage payments. It revealed the frustrations and fears for the future held by people, such as single parents and older workers, who have lost their housing security and asset, and find themselves renting unexpectedly or forced to move away from an area in which they have well-established connections to family and social networks, employment and/or schools for their children. It described the experience of grinding poverty and social exclusion of very low income renters, many of whom are single people for whom public housing is unsuitable or unavailable, and the pragmatism of many other young renters, including singles, couples and families, who have given up on ever owning a home.

Profound changes have occurred not just in housing markets, but also in labour markets and family structures over the past two decades. Linking an appreciation of those major contextual factors to the detailed findings of the research on housing affordability underlines the importance of having a good understanding of the implications of declining housing affordability and helps to show why different and more flexible policies are needed to respond to current housing issues. For example, home-buyers with large and extended mortgage commitments have greater vulnerability than in the past to changes in employment or interest rates. Therefore additional protective measures may be needed to offset the risk burden of these households. New proactive interventions may be required to prevent home purchasers losing their homes due to a change in their personal circumstances. At the very least, such interventions may be required to support their transition to another housing option. For the group of Aspirant purchasers, policy directions should recognise that it may be the inability to obtain a secure, full-time better wage job that is preventing transition to home ownership. Therefore, programs that provide additional incentives to this group geared to their housing aspirations will be desirable.

The situation of retirees and older workers in the trapped renter group helps to show the dynamic risks of renting over the life course. Individually, these households have become more vulnerable to housing stress on leaving the workforce or following loss of a partner (and their income). As future growth in the size of this group occurs as a result of both demographic and housing tenure trends, there will be repercussions at the system level for retirement income policies and the capacity of a cohort of lifetime renters to contribute to the costs of their aged care²¹. Overall the trend to long-term renting indicates that there will be an increasing need for well-located housing that can offer more security and choice to the expanding group of younger renters at rents they can afford.

4.4.1 Home ownership challenges

In Australia, home ownership, long supported both implicitly and explicitly by government, has been the preferred tenure of both renters and owners, and imbued as part of the Australian 'settlement' and the Australian 'dream'.²² Putting substance behind the dream has traditionally required a line of credit underwritten by expectations of long-term, stable and typically rising income through full-time employment. However, long-term structural shifts over the past 10–15 years have challenged these traditional foundations and the risk profile of lending has had to adapt, with much of that risk passed on to the borrower.²³

Rates of home ownership among younger households have fallen in Australia over the past two decades right across the income distribution for a variety of reasons (not only related to housing affordability), and it is unlikely that historic rates of ownership among this group will return in the foreseeable future (RP10, RP11).

Although there will be fewer new home buyers than in the past, there will still be many young households, such as lone person households and those on single incomes, who aspire to home ownership and who are strongly motivated, but lack sufficient means, to achieve it.

Many modest-income households entering home ownership have a greater risk of affordability problems in the future. Higher levels of indebtedness make such households more vulnerable to an unfavourable change in their personal and financial circumstances, as well as to any rise in interest rates or decline in house prices that may arise from economic circumstances or other exogenous factors. Affordability risk for highly indebted households typically is greatest in the first few years of a new

mortgage, but it may continue for longer where household income growth does not occur, the loan principle is not being reduced, or the value of the house falls.

There will also be a cohort of established buyers who may be forced to abandon home ownership following family breakdown or loss of employment income.

4.4.2 Rental challenges

The role of the private rental sector has moved beyond one of acting mainly as a transitional tenure and pathway into home ownership or public housing. Changes to the affordability of housing and the greater variety of housing careers (NRV2), labour market changes and other factors have resulted in rental housing now becoming a long-term tenure for many low-income, low-wealth households.

This trend seems likely to continue for a variety of reasons. Not everyone who aspires to enter or re-enter home ownership will be able to do so, even if more diverse assistance measures such as those discussed above are offered. Many households who are eligible for public housing have had to continue to rent privately because places for lower-income households in public housing are becoming more restricted. Others may find the limited choices available in public housing too restrictive to meet their shelter and non-shelter needs.

The rental market can therefore be expected to increase its share of the overall housing system as both of the other main tenures decline somewhat. Greater reliance on long-term renting by lower-income households will also contribute to a developing trend towards polarisation of housing tenure according to wealth and income.

Existing policies are not adequate to address these challenges. Most tenants do not have the option of long-term leases under present regulatory arrangements, and bad experiences in searching for, obtaining and/or keeping accommodation seem to be common. Large numbers of private renters have unaffordable housing even after additional welfare assistance is provided. If long-term renting becomes lifetime renting, affordability problems look set to deepen for a cohort of older renters who rely on government pensions or have limited personal superannuation. In the absence of other policy action to stimulate more affordable forms of housing, this will put growing pressure on governments to increase pensions (or rent subsidies).

On the supply side there is clear market failure evidenced by a lack of investment at the lower end of the rent range, widening gentrification of previously low-rent stock and the upgrading of housing in urban renewal areas and corridors. The recent experience of instability in rental investment has also had ramifications for rents and house prices. There is also declining capacity in the traditional alternative tenure for long-term renters – public housing.

4.4.3 Meeting the challenges

In view of the failures of the current housing market and policy system to provide sufficient housing that can meet the essential shelter and non-shelter needs of lower-income households, housing policies in all tenures need to be reformed in order to improve access to affordable housing, offer more tenure choices and options in all locations, and respond better to circumstances where a household's housing is put at risk. Importantly, if housing policy goals are to be combined with goals to improve people's life opportunities, housing policy responses should be designed to provide more encouragement for households to benefit economically when opportunities arise – for example by assisting (or at least not constraining) a move to a better job in a different location or by providing savings incentives linked to obtaining equity in a home.

For the longer term, more active consideration will need to be given to innovative ways of generating opportunities for housing security and wealth creation over the life course for low- and moderate-income earners, if lifetime reliance on government subsidies for housing is to be prevented (RP11). At a systemic level, curbing house price inflation will be critical if future generations across the income distribution are to have access to wealth benefits through home ownership (RP10).

In other words, dealing effectively with housing affordability problems will require a clear understanding of how different causal factors interact to affect the housing market. For example, affordability will not improve if provision of additional income support to households in housing stress is not matched by a supply side response because of bottlenecks in the housing market and a price effect results instead. An integrated set of policy responses capable of addressing the range of factors that contribute to poor affordability will therefore be required.

5 POLICY IMPLICATIONS

The findings of this extensive study make a compelling case for the need for governments to ameliorate the housing affordability stress currently being experienced by many lower-income renters and, to a lesser extent, marginal home buyers, and to improve housing affordability conditions in Australia in the long-term. This chapter draws out the broad principles that follow from the research findings, provides examples of some illustrative policies that satisfy these principles and signals some of the wider policy actions needed to promote affordable housing.

5.1 Policy directions

5.1.1 Policy principles

A number of general principles to guide a strategic policy response to the challenges of declining housing affordability can be drawn from the analysis and evidence presented in this study. The policy principles that derive from the main conclusions of this study are listed in Box 5.1.

Box 5.1: Research findings and policy principles

<i>Main conclusions</i>	<i>Policy principles</i>
Housing affordability is a large and widespread problem.	Additional policies and outlays will be needed to offset housing affordability problems.
Causes of affordability problems are complex and diverse. Major driving factors can be found both within the housing system and beyond it.	An integrated set of policy responses capable of addressing the range of factors that contribute to poor affordability will be required. Both housing policy action and action in other policy arenas will be required.
Housing affordability is a structural problem.	While housing assistance can address the housing stress of individual households and provide a safety net for those at risk, it will be insufficient to overcome the underlying causes of declining affordability.
Housing affordability problems are predicted to increase in the first half of the 21st century.	Sustained action will be required to prevent housing affordability problems worsening.
Affordability problems have specific spatial and cyclical dimensions.	Policy responses need to be tailored to different local market contexts and to be responsive to changing economic conditions. A strategic framework that guides the actions and priorities of different players will be required, in order to promote cohesive action and to avoid fragmentation of policy responses.
Households most at risk of facing the multiple problems that arise from a lack of affordable housing are lower-income households in the private rental market.	Policy responses to the needs of individual households should give greatest attention to those in the private rental market.

<i>Main conclusions</i>	<i>Policy principles</i>
Individual households experience and address housing affordability problems in different ways.	Providing a range of choices and options is desirable to meet differing household needs and aspirations. Policies that assist households to obtain affordable housing should as far as possible be designed to be responsive to their individual needs and to adjust to changes in those needs.
Housing markets have failed to provide an adequate supply of affordable housing for lower-income households.	Policies to promote efficiency in the housing market and to support a greater permanent supply of affordable housing should be given greater weight than is currently the case.
While housing provides shelter, it also influences non-shelter outcomes for individual households, such as workforce participation, access to jobs and services, family stability and educational attainment.	The goal of improving housing affordability needs to be aligned with other relevant objectives of governments.
Declining affordability has implications for economic performance and labour market efficiency, social cohesion and polarisation of cities, environmental considerations and the creation and distribution of wealth through home ownership.	Failure to address housing affordability problems will jeopardise the achievement of wider government goals.

5.1.2 *Current policy settings*

NRV3 research did not include a direct review of how current policy settings affect housing affordability. However, the findings of the research point to key weaknesses and limitations in current approaches to assisting households to access and maintain affordable housing.

For instance, it is apparent from the quantitative and qualitative analysis of affordability that the current core housing policies that operate to assist lower-income home buyers and renters are not adequate.

- Current forms and levels of government assistance for lower-income aspirant purchasers and struggling first home buyers are unlikely to provide many in these groups with a path to affordable and sustainable home ownership.
- The large Commonwealth Rent Assistance (CRA) program has alleviated housing affordability problems for many renters but has not prevented a growth in the number of private renters in housing stress and leaves hundreds of thousands of households (comprising both recipients and non-recipients of CRA) with severe affordability problems. Any pressures on rents could mean that blunt instruments like this are less effective in the next housing market cycle.
- Targeting social housing and other measures of assistance tightly on those with the highest needs has created a gap in assistance for those households (such as low-wage workers) for whom a smaller amount of financial support or additional well-located additional affordable housing could provide housing closer to labour market opportunities and/or lift them out of housing stress.
- As there is insufficient capacity to maintain or expand the provision of social housing under current funding arrangements, this traditional source of low-cost supply is retracting. This is leaving many very low income renters who are eligible

for social housing stranded in the private rental market, where they face ongoing unaffordable rents.

- Changes to allocation policies, which have reduced access to public housing for many lower-income families starting out on the housing ladder, have eroded the capacity of these families to save for home ownership.
- The regulatory framework in the private rental market does not address the needs of long-term renters.

In the broader environment, policies that affect housing have contributed to the increased risk of affordability problems. For example:

- Relaxation of regulation of home lending practices has been one factor contributing to the growth of heavily indebted marginal home buyers with greater vulnerability to housing stress.
- Current approaches to planning and managing residential development and urban renewal in our major urban and regional areas are not sufficiently directed to promoting a wider range of affordable housing options and to generating more socially mixed communities.²⁴
- Tax policies that directly affect demand for and investment in housing (see RP10) are not geared to protecting or promoting the affordable end of the market. Under recent market conditions, tax provisions and changes to them have tended to act against affordability goals by overstimulating housing investment and adding to the demand for owner-occupied housing.²⁵
- Limited coordination between federal, state and local government policies that affect affordability outcomes weakens overall efforts to address the problem.

5.1.3 A new policy framework

To achieve effective and sustainable improvements in housing affordability for individual households in stress and for future generations, governments across Australia now need to adopt a balanced set of policy reforms under a common vision, purpose and framework for implementation.

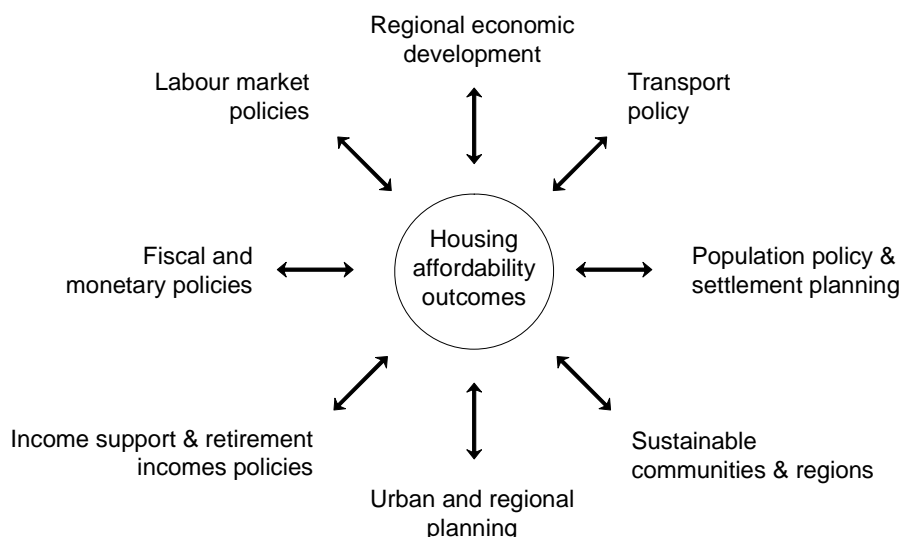
A coordinated cross-government response that applies both housing policy tools and other policy levers will be required, to address the needs of individual households and to redress systemic housing market problems.

Specific housing policy tools will be appropriate to alleviate housing stress and to help to offset patterns of social and economic exclusion that are often associated with situations of unaffordable housing. However, the qualitative research findings of this study indicate that a more nuanced and flexible housing policy approach than in the past will be needed, to respond to differing experiences of housing affordability problems and the diversity of effects these may have on people's lives and livelihoods. Accordingly, a variety of new policy options (designed to achieve improved outcomes for low-income renters and marginal home buyers in housing stress, as well as those at risk of severe stress) are suggested in section 5.2.

However, a broader set of policy actions (beyond housing) will also be required, for a more lasting impact on the housing affordability challenge. The complex interactions between housing policies and macro policy settings provide a strong rationale for arguing that housing should be a core area of interest for government as a whole. In particular, policies that influence economic development and labour market performance, fiscal and monetary policies, transport planning and infrastructure provision, population policies and settlement planning, income support policies, and agendas to improve urban and regional sustainability, need to give greater emphasis

to addressing housing affordability problems among other goals. It is through adjustments in these key areas that actions to alleviate housing stress in the short-term will be buttressed by broader strategies that can address the underlying causes and wider impact of deteriorating housing affordability.

Figure 5.1: Macro drivers of housing affordability outcomes



The evidence of the structural nature of the housing affordability problem presented in RP3 and RP10 (and summarised in Chapter 2) and future projections (RP11) show that housing affordability problems will continue and deepen.²⁶ It is only with an overarching public policy goal of steadily and consistently improving the affordability of the housing market over time, using both housing policy tools and other policy drivers, that governments may be able to contain the endemic affordability problem and, thereby, curtail growth in the need for ever more direct housing assistance measures, as well as manage the risks to the economy posed by persistent house price inflation. Thus macro policy settings, in particular, must take greater account of the need to reduce the pressures on house prices in the medium- and long-term.

Not only are more diverse and proactive strategies required but also these must be developed and implemented cohesively. Stronger coordination and cooperation between agencies and spheres of government will be essential, to:

- Ensure that actions outside the housing policy arena do not have adverse effects on housing affordability
- Prevent fragmentation of the effort directed towards tackling affordability across different government bodies
- Encourage more integrated approaches to interventions on the supply and demand side and to the delivery of different forms and mixes of housing assistance.

5.1.4 Specific objectives

Primary and supporting objectives for a new affordable housing policy model were developed as part of this study (see RP7 and Box 5.2). The proposed objectives represent a set of broad goals to drive a policy agenda consistent with the policy principles that have been derived from the research findings. The objectives recognise the specific purposes and processes behind ways of providing more affordable housing and also acknowledge a range of other desired economic, social and spatial outcomes that are potentially affected by how affordable housing is produced, financed and delivered. Adoption and application of these objectives by governments as part of a coordinated national approach will lead to specific policies that can address the housing risks and problems being experienced by individual households, provide overall improvements in housing affordability and boost the social and economic benefits to both individual households and the broader community that arise from having more appropriate and affordable housing.

Box 5.2: Policy objectives for a national affordable housing policy framework

<i>Primary objective</i>	
Affordable housing	<p>To improve access to existing housing that is affordable for both low- and moderate-income households and those with specific housing needs in housing affordability stress (the target groups).</p> <p>To preserve and add to the supply of affordable housing where it is needed for the target groups.</p>
<i>Supporting objectives</i>	
Appropriate housing	<p>To ensure that housing provided is appropriate to the needs – and changes in needs – of the target groups in response to:</p> <ul style="list-style-type: none"> → size and type of household → cultural needs of households → occupant circumstances (eg need for support services; stability) → locational needs of households. <p>To provide well-designed housing and neighbourhoods.</p> <p>To contribute to the environmental sustainability of dwellings provided to the target groups.</p>
Participation	<p>To enable the target groups to participate in decisions about affordable housing policies, products and projects.</p>
Positive non-shelter outcomes	<p>To ensure that target groups have sufficient residual income after paying for housing to meet their non-shelter needs at a socially acceptable standard.</p> <p>To provide affordable housing in ways that can strengthen the economic and social position of the target groups. Consideration should be given to:</p> <ul style="list-style-type: none"> → incentives for workforce participation → support for family life and work/family balance → ways of supporting the health, wellbeing and education needs of occupants → enabling ageing in place → development of socially cohesive communities and community-building processes.

Choice	To diversify the housing and tenure options available in local housing markets and to provide the target groups with adequate choice.
Equity	To target any subsidies that are provided to the target groups in proportion to need. To give priority of assistance to those most in need.
Long-term benefits	To retain and use any benefits gained from investing in housing for the target groups to meet the needs of future generations. To progressively improve the capacity of the private and the not-for-profit sectors to provide affordable housing.
Unintended effects avoided	To avoid as far as possible any unintended effects of the way in which initiatives intended to improve the affordability of housing are implemented. (For example, to avoid measures that contribute to a sudden surge in demand and a consequential short-term boom in house prices.)
Efficiency	To use any subsidies that are provided to access, procure, manage and maintain housing in the most cost-effective way. To support and contribute to the efficient operation of the housing market.

5.2 Illustrative policies

It is not the purpose of this summary report to present a full range of possible policy responses to housing affordability problems or to describe particular policy options in detail. Those tasks will require a rigorous process of review of existing housing policies and the careful development of additional strategies capable of responding to the findings of this and previous research.

Any policy adjustments and new policy initiatives that aim to tackle affordability problems should be monitored and evaluated systematically. (RP7) This process is essential in advancing the understanding of which policy levers work to improve affordability in particular market contexts and why. It also ensures that both existing policies and any new directions remain effective and appropriate in the context of highly dynamic and diverse housing market conditions and the shifting influence of demographic, economic and social developments.

To illustrate the types of policy developments that may be appropriate, some ideas and options are provided below. The first part concerns specific housing measures that can be used in the short to medium term to alleviate housing stress among renters and home buyers. The second part concerns wider policy actions to promote affordable housing in the long term.

5.2.1 *Revitalising policies to support forms of home ownership*

Priority responses to declining access to and affordability of home ownership need to be directed at:

- Assisting more aspirant purchasers to obtain equity in their own home
- Mitigating risks to the loss of equity of home buyers under changed circumstances (where feasible)
- Helping those households who have to relinquish their own home to make the transition to an affordable and appropriate alternative.

Until there are long-term improvements in housing affordability, not all households (like the Aspirant purchasers in this study) who wish to buy their home are likely to be

able to do so. However, in the short term, some income-constrained Aspirant purchasers could benefit from:

- The opportunity for using shared ownership models that can assist them to obtain an equity share in their own home. This might also include accessing some of the benefits they would otherwise receive as renters for a period (such as rent assistance), or being eligible for similar concessions to those available to first home buyers.
- Receiving assistance with mortgage repayments in the early years by way of a tax credit or rebate, or by receiving subsidies additional to the First Home Owners Grant (FHOG) over a period of several years
- Having stronger incentives to save specifically for housing through government-matched savings schemes or similar models.

Some of those currently purchasing who are financially stretched could take advantage of a well-regulated option to reduce their equity share, while retaining control over their existing housing. A similar option may be appropriate for some households who would otherwise be forced to relinquish their housing after a change in their circumstances. A beneficial option for new households forming as a result of family breakdown would be to provide them with access to benefits similar to those available to first home buyers (such as FHOG and stamp duty exemptions) in certain circumstances.

A key means of increasing the protection of households vulnerable to losing their home would be to strengthen measures that insure against this risk. Market products (such as income protection insurance) are most expensive for those most at risk and therefore add to the affordability gap. Compulsory mortgage insurance together with the offer of some assistance with meeting the costs for marginal buyers in the early years of the mortgage would reduce the exposure of both the individual borrower and governments to mortgage foreclosure without adding to costs for those who can least afford it.

Far-reaching changes in mortgage markets that have followed from financial deregulation have created greater choices for housing consumers, but also have exposed them to greater risk. The introduction of new tenure options, such as the variety of forms of shared equity and shared ownership that are now being explored in the housing finance sector, may add to this complexity and risk. In this increasingly dynamic mortgage lending environment, there is a greater role for independent and proactive household and community information and education programs. In this context, the core purposes of these government-sponsored programs would be to assist prospective buyers to make well-informed choices about financing their housing and to help to prevent such buyers entering into unsuitable or unsustainable forms of home ownership.

The principles proposed above include one that stressed the importance of giving more emphasis to supply side actions in housing policy to balance the currently dominant demand side measures. Accordingly, affordability barriers to home buyers should also be addressed by providing more affordable housing for sale in new developments and urban renewal areas where the market is not providing affordable housing at present. A range of policy levers could be used to steer the development of more market provision of affordable housing for sale to marginal buyers, including more widespread use of planning requirements, incentives and bonuses, government land supply initiatives and encouraging not-for-profit building. Anti-profiteering measures also would be necessary to ensure that the benefits of offering lower-priced homes for sale were not exploited. State land development agencies and the existing

not-for-profit sector could play key roles respectively in developing and allocating this housing in accordance with public policy goals.

As suggested above, it may be desirable to increase government support for forms of shared home ownership in the future to address declining access to home ownership by lower-income households and to respond to other specific needs. However, before embarking on this direction, it will be critical for governments to consider ways of preventing shared ownership initiatives from exacerbating house price inflation, through providing a demand stimulus without a corresponding supply response. To mitigate this risk, policies for shared equity /shared ownership need to consider the extent to which any government-led schemes should:

- Link provision to new supply
- Ration and target the products made available
- Accredite and/or regulate equity partners.

5.2.2 A policy framework for long-term renting

The role of the private rental sector has moved beyond one of acting mainly as a transitional tenure and pathway into home ownership or public housing. Changes to the affordability of housing and the greater variety of housing careers,²⁷ labour market changes and other factors have resulted in rental housing now becoming a long-term tenure for many low-income, low-wealth households, whether by choice or by necessity.

These changes in the rental market have generated the need to ensure that it is capable of meeting the long-term needs of a larger number and greater variety of lower-income households than in the past. A strategic rental housing policy framework is essential to foster adequate and stable levels of investment in rental housing and to develop management and regulatory arrangements that are suited to long-term renting.

Developments in the financing and delivery of rental housing in countries comparable to Australia, and extensive local research on options for boosting the supply of rental housing, have helped to demonstrate that two interrelated policy reforms hold the key to providing larger amounts of rental housing that is affordable and suited to the needs of long-term renters.²⁸

The first reform required is to put in place the institutional and subsidy arrangements that will attract institutional investors, especially superannuation funds, to invest in larger amounts of well-located good quality rental housing. (RP2) Many detailed options for how to facilitate and channel large-scale private debt and/or equity capital into affordable housing have already been identified and researched in Australia.²⁹ Governments now need to act on that advice.

The second key reform is to boost the capacity of the not-for-profit sector and other regulated landlords. Their role is to allocate and manage housing that can be funded through institutional investment and other potential public and private sources in order to meet public policy requirements for the provision of adequately maintained and secure housing for those groups whose needs are not being met in the existing, lightly regulated, private rental market.

These two reforms go hand-in-hand. With institutional investors interested in long-term investment in a housing asset class (without wanting responsibility for managing the assets) and with dedicated rental managers acting in a complementary role to manage the housing assets, new opportunities are available to provide long-term rental options. Through accreditation and public regulation, housing managers can

also fulfil specific public policy objectives such as assisting allocation of the housing produced to nominated groups, ensuring that any subsidies provided achieve the housing outcomes that are intended, supporting community building functions and helping to broker appropriate personal support or other services as needed. Small initiatives along these lines have begun in a number of jurisdictions (see RP2 and RP7), but a consistent national policy framework is necessary to achieve investment levels at a scale that is commensurate with need and that will be cost-effective and sustainable. Investment in building the capacity of organisations to manage larger volumes of affordable housing and supporting infrastructure will also be required. (RP2)

To respond to the changing needs of households renting and to address the trend to greater mobility over their life course, more flexible housing policies and subsidy arrangements are desirable. For example, as suggested in RP9, a flexible package of options could be designed to assist tenants to manage the transitional costs associated with changing housing so they can afford to move to an area that may offer them better opportunities. Rent guarantees (which have been piloted in New South Wales) could also be used more widely to secure housing for those groups that experience most difficulty in competing in the private rental market. Other ideas that have been suggested that could provide for greater flexibility and choice include:

- Having the option of long-term leases in the existing private rental market
- Making rent assistance payments available as either a lump sum or a home buyer subsidy in order to provide an incentive to those renters who could potentially afford to move into low-cost home ownership.

The extent of housing stress and associated affordability problems in the private rental market revealed in this research also points to a need to review whether current mainstream forms of assistance (such as CRA and various state government administered rent support programs) should be adjusted or enhanced to improve the outcomes from these existing programs overall and to be more responsive to the diversity of situations that place renters in stress. However, as discussed above, ways of providing additional assistance to individual low-income private renters would have to be carefully designed in order to avoid adding to existing rent pressures and investor instability, and to be cost-effective for governments.

One way of reducing housing stress arising from high rents relative to household income would be to establish a budget-controlled program of additional rent subsidies tied to achieving specific outcomes.³⁰ Such an approach would be in keeping with overall policy objectives of providing more flexible options to increase choice for low-income tenants and create pathways to improved self-reliance for them. It would also avoid the risk of over-stimulating demand for rental housing that could result from a general increase in rent assistance. Under this model, criteria would be established to ration the allocation of 'top up' subsidies in order to reduce affordability stress. Criteria for allocating additional subsidies could be designed to achieve some or all of the following:

- Attract or retain essential low-wage earners in high-priced markets.
- Support labour market mobility, particularly in industries or areas with labour shortages.
- Encourage work-ready public tenants to relocate closer to jobs.
- Allow older renters to remain in their home for a period after loss of a partner.

- Provide greater levels of assistance (commensurate with that available in public housing) for those in the worst stress (eg some large families) who cannot find other appropriate housing.
- Stimulate additional supply by regulated affordable housing providers.

In addition to measures aimed at providing additional affordable rental housing in the private market, an open debate about the future role of the social housing system should be an immediate priority. In the context of policies to improve housing affordability, this will be important for several reasons: to ensure that the level of provision of social housing does not decline further; to identify other affordable housing options that might be beneficial to social housing tenants; and to consider how to better integrate existing providers of social housing (and their assets) into a more diversified system of affordable housing provision. A social housing system of provision and allocation that results in a segregated and stigmatised form of housing offering little choice or flexibility is not seen as desirable by many prospective tenants. (RP9) Considering management reforms, accelerating reconfiguration of the existing stock of social housing, developing more socially mixed estates and providing greater social and geographical mobility for social housing tenants should be considered part of the new affordable rental housing policy agenda.

5.3 A national goal

An overarching national policy goal to improve housing affordability is required to turn around the profound affordability problems that are inherent across Australian housing markets and have significant implications for the whole community and for future generations. Such a goal would help to position housing affordability alongside other high-level government objectives such as those concerned with economic prosperity, health and wellbeing, and environmental sustainability. It would help to raise awareness of housing issues and foster greater understanding of the impact of a range of government actions on the housing market and on housing affordability in particular.

The national goal to improve housing affordability should be supported by a national strategic policy framework that would guide the actions and priorities of governments in all spheres and encourage the engagement of both public and private sector agencies in the task. Commonwealth, state/territory and local governments would be required to put in place long-term strategies for improving housing affordability outcomes and combating tenure and spatial polarisation trends deriving from housing market processes in accord with the roles and responsibilities defined under the national framework. Engagement of all spheres of government working to a shared agenda is crucial to ensuring that policy actions are strongly coordinated and sufficiently responsive to differences in regional and local housing needs and market conditions.

A specific mechanism for developing and reviewing policies in support of the national goal to improve housing affordability should be incorporated under the framework of the Council of Australian Governments (COAG). The brief of national and state Ministers for Housing could be widened to include an advisory role on whether other key government policies that have a direct or indirect impact on the operations of land and housing markets are consistent with the goal to improve housing affordability. Devices such as housing impact statements, a national housing affordability monitor (see RP7) and affordability targets could be used to support that role.

A series of independently conducted public reviews of major public policy areas that are having a significant impact on housing affordability would also be desirable, to

improve understanding of the wider causes of affordability problems, to build support for policy change and to identify the adjustments in each policy arena and sphere of government that will be necessary to contribute to sustainable improvements in housing affordability in both the ownership and rental sectors. Priority areas for review would include:

- Tax, savings and investment policies affecting the housing sector
- Land use and transport planning policies and infrastructure investment
- The role of regional strategies in promoting more affordable housing.

Ignoring the risks to housing affordability created by these major public policy areas is akin to ignoring the elephant in the living room in Figure 1.1 at the start of this report.

5.4 The way forward

Housing affordability has emerged as the key challenge facing housing policy makers in developed countries at the start of the 21st century. Consequently, addressing affordability problems is now a priority for governments in many countries, and a broad variety of strategies are being put in place to improve the efficiency of housing markets, to increase supplies of affordable housing, to respond to housing-related financial pressures on individual households, and to promote innovative housing tenure and housing finance options for those households being excluded from the housing market.³¹

The findings of NRV3 research summarised in this final report reinforce and extend those of previous Australian studies and indicate that a broader, nationally driven and well-coordinated approach is now needed in Australia to tackle both the drivers and the consequences of a long-term decline in housing affordability.

A set of four key strategies that would be capable of addressing a core goal of improving housing affordability can be distilled from the discussion of policy principles and illustrative policy options above. Successful application of these combined strategies could be expected to result in significant economic, social and environmental benefits for individual households, for governments and for society, in the short and long term because of the significant and far-reaching implications of the affordability of housing.

- First, concerted action is necessary to drive down costs and prices in metropolitan and regional housing markets prone to house price inflation, especially through reducing impediments to housing supply, improving the efficiency of the residential development process and reforming those tax settings that can adversely affect the price of housing in particular market contexts, either by stimulating demand or by adding to costs.
- Second, existing or additional demand side assistance programs (such as FHO, CRA and other forms of financial assistance to individual households) can be used to secure better access to those parts of the housing market that are more affordable for lower-income renters and struggling home buyers in particular circumstances, where their effectiveness can be demonstrated. Importantly, however, the qualitative research findings highlight the appropriateness of developing flexible housing assistance policies that will be more responsive to the diversity of circumstances and aspirations of individual households in, or at risk of, housing stress.
- Third, a national policy, funding and delivery framework designed to secure substantial private investment in an additional supply of well-located affordable housing for rent and for sale is essential in order to stimulate provision at the

affordable end of the private market and to redress the decline in social housing provision.

- Finally, changes to the social housing system are required, to secure the viability of this existing source of low-cost housing and to better integrate existing service providers and assets into an expanding sector of affordable housing. In particular, reform should be oriented towards overcoming the current residualisation of this sector and towards increasing housing and other options and, where needed, the mobility of those lower-income households (such as people with complex needs, single parents, older people and Indigenous households) who rely most on social housing.

Figure 5.2: Core strategies to improve housing affordability



In conclusion, a joint, strongly coordinated national framework is vital to addressing Australia's housing affordability crisis and to mitigate the broader risks that the systemic decline in housing affordability poses to future generations.

Tackling this crisis requires leadership from all spheres of government and a long-term commitment to a whole-of-government approach that uses housing and non-housing public policy levers.

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APPENDIX: NRV3 RESEARCH APPROACH AND OUTPUT

A.1: Research strategy

The research for NRV 3 was undertaken in three stages. A summary of these stages relating them to the research questions that were addressed, the specific research papers produced for NRV3, and how these relate to the structure of this report was provided in Table 1.1 in Chapter 1.

Stage 1 provided the background and conceptual framework for the NRV. It consisted of a comprehensive review of existing literature in order to establish the existing issues and evidence base in the relevant areas identified for NRV3 research. The key outcomes are discussed in this report. Full details can be found in the original research plan for NRV3 and in Research Paper 1 (RP1). This review identified the key issues that were built into research work undertaken in Stages 2 and 3.

The research in Stage 1 also identified the broad range of policy levers available for addressing affordability problems. These are reported in detail in RP2. A companion paper (RP7) proposed a set of high-level objectives that could logically underpin a national affordable housing strategy aimed at addressing the problems identified by the Stage 2 and 3 research. It also developed a model for implementing a proactive, systematic and achievable program of evaluation, suitable for application to both current and prospective policy initiatives that aim to increase access to affordable housing for low- and moderate-income households in Australia. A consultative process informed each step of this policy-related research, as outlined in the relevant research papers. The work undertaken in Stage 1 research addressed the first and last questions defined for the research program.

Stage 2 consisted of two distinct but related tasks.

The first task was to provide evidence on the extent of housing affordability problems in Australia. This focused on the question: who has an affordability problem? This was addressed initially at an Australia-wide level, relying on a secondary data analysis of relevant surveys. A key aim of this part of the analysis was to identify the size of the potential problem and to determine how sensitive these estimates were to the affordability measures employed. The secondary data analysis also provided an indication of the extent to which affordability problems were enduring for those experiencing them and an indication of trends over the past decade. A follow-up paper analysed the trends in more detail. The key results from this quantitative research are presented in Chapter 3. Detailed results can be found in RP3, RP8 and RP10.

A second key aim of the quantitative research was to identify the types of households potentially at risk of having an affordability problem because of the burdens that their high housing costs imposed on their incomes. The results of this part of the broad-based quantitative analysis were used to inform the more detailed analysis of those at risk. This more detailed analysis was undertaken in a three-step process.

1. *The first step* consisted of using census data to identify locations (described by postcodes) where there was a concentration of types of households identified as having high housing costs in relation to their incomes and, therefore, at risk of facing problems as a result of poor housing affordability.

2. *The second step* involved a quantitative survey, which targeted households in a number of these locations. This was designed to provide a richer analysis of households at risk than was possible from secondary data. It was also designed to identify some of the problems faced by those with a housing affordability problem.

3. *The third step* involved a qualitative survey of households selected from those targeted from the customised survey based. This used data from focus groups and interviews to generate a more in-depth analysis of how the problems they face affect their every day lives, to give an indication of why affordability problems are important.

The key results from this stage are presented in Chapter 3 and 4. Detailed results can be found in RP9. These are supplemented by quantitative research focusing narrowly on the relationship between housing affordability and financial stress and reported in RP6.

The second task in Stage 2 addressed the third of the research questions identified above: why does affordability matter? This focused specifically on outcomes at the macro or economy-wide level and on at the micro or household-specific level, following the taxonomy of the drivers of affordability problems identified in the literature review undertaken in Stage 1. The drivers of affordability problems and their structural nature are covered in Chapter 2 below. The second task in Stage 2, however, was to examine the effects of affordability problems, not the drivers of those problems.

A two-pronged approach was employed for this task.

1. The effects of affordability problems on households experiencing such problems were a focus of the Stage 2 surveys. They have also been covered in a detailed literature review undertaken on housing and non-shelter outcomes for NRV1 (Bridge et al, 2003). Results are covered in detail in the relevant research papers (primarily RP9 but also RP6) and covered in Chapters 3 and 4 of this report.

2. The macro effects of affordability problems were covered by two desk-top research projects. The first covered the impact of housing in general and housing affordability in particular on the economy. The second covered the impact on labour market outcomes and focused specifically on the questions of how housing affordability influences labour market decisions and how employment prospects and careers of low- and moderate-income earners are affected by housing costs. The conclusions drawn from this second desktop project were reinforced by some of the results from the Stage 2 surveys. The results from both are reported in RP4 and RP5 and the key issues from them integrated into the overview in Chapter 5.

Stage 3, the final stage of NRV3, consisted of integrating the quantitative work done in Stage 2 with a related AHURI housing futures project on the Australian Housing System and Intergenerational Sustainability. This project used results from Stage 2 research, which set the scene for a scenario modelling exercise intended to determine the likely extent of housing affordability problems into the future. The detailed results from this modelling are available in the RP11. The key results, which address research question five – What are projected affordability problems into the future? – are reported in Chapter 2 of this report.

A.2: Research output

All research papers can be found on the AHURI website at http://www.ahuri.edu.au/nrv/nrv3/NRV3_Assoc_docs.html

Full CRV Plan

Yates, J., Berry, M., Burke, T., Jacobs, K., Milligan, V. and Randolph, B. (2004) *Housing Affordability for Lower Income Australians*, August 2004.

Research Paper 1

Gabriel, M., Jacobs, K., Arthurson, K., Burke, T. with Yates, J. (2005) *Conceptualising and measuring the housing affordability problem*, August 2005.

Research Paper 2

Milligan, V. (2005) *Directions for affordable housing policy in Australia: Outcomes of a stakeholder forum*, August 2005.

Research Paper 3

Yates, J. and Gabriel, M. (2006) *Housing affordability in Australia*, February 2006.

Research Paper 4

Berry, M. (2006) *Housing affordability and the economy: A review of macroeconomic impacts and policy issues*, June 2006.

Research Paper 5

Berry, M. (2006) *Housing affordability and the economy: A review of the labour markets impacts and policy issues*, August 2006.

Research Paper 6

Yates, J. (2007) *Housing affordability and financial stress*, August 2007.

Research Paper 7

Milligan, V., Phibbs, P. with Gurrán, N. and Fagan, K. (2007) *Approaches to evaluation of affordable housing initiatives in Australia*, July 2007.

Research Paper 8

Yates, J. (2007) *The polarisation of housing affordability*, August 2007.

Research Paper 9

Burke, T. and Pinnegar, S. with Phibbs, P., Neske, C., Gabriel, M., Ralston, L. and Ruming, K. (2007) *Experiencing the housing affordability problem: blocked aspirations, trade-offs and financial hardships*, August 2007.

Research Paper 10

Yates, J. (2007) *Access to home ownership: past and present*, August 2007.

Research Paper 11

Yates, J., Kendig, H. and Phillips, B. with Milligan V., and Tanton, R. (2007) *Sustaining fair shares: the Australian housing system and intergenerational sustainability*, August 2007.

SOURCES FOR TABLES AND FIGURES

Figure 2.1: Real house prices and income trends in Australia: 1960–2006

House prices from Productivity Commission (2004), updated to 2006 by ABS Cat. No. 6416.0, Table 10; Household incomes from ABS Cat No. 5204.0, Table 46 divided by household estimates interpolated from census data, adjusted upwards by 10% scale factor to match ABS Cat No. 3229.0 and 3236.0

Figure 2.2: HIA housing affordability index, Australia: 1984–2006

Source: HIA Housing Reports, various years (data supplied by HIA)

Figure 2.3: Deposit gap affordability index, Australia: 1984–2006

Source: Median house prices HIA Housing Reports; Average weekly ordinary time earnings, full time adults from ABS 6302.0 Table 3; June 1971 to June 1981 derived from AWE (national accounts); prior to 1971 based on AWE male earnings (RBA OP No. 8)

Figure 2.4: Average housing cost ratios, Australia: 1975-6 to 2003-2004

Household Expenditure Surveys, various years (ABS Cat. No. 6530.0; 6531.0; 6516.0). Housing costs for purchasers include repayments of mortgage principal, (based on Surveys of Income and Housing usage rather than HES usage).

Figure 2.5: Determinants of housing affordability

Based on Figure 1.1, Productivity Commission (2004)

Figure 3.1: Proportion of households with unacceptably high housing cost ratios

ABS Survey of Income and Housing, 2002-03, confidentialised unit record files. Data reported in RP3.

Figure 3.2: Numbers and incidence of households at risk

ABS Survey of Income and Housing, 2002-03, confidentialised unit record files. Data reported in RP3.

Figure 3.3: Characteristics of selected lower-income households at risk

ABS Survey of Income and Housing, 2002-03, confidentialised unit record files. Most data reported in RP3.

Figure 3.4: Housing stress and housing affordability problems

Derived from results in RP3, RP6 and RP9. Based on data from confidentialised unit record files from ABS Surveys of Income and Housing, 2002-03 (reported in RP3) and 2003-04 (reported in RP6) and surveys undertaken specifically for NRV3 (reported in RP9).

The specific estimates reported In Figure 3.4 have been obtained by applying the RP9 estimate of 40 per cent of private renter households (described as Strugglers and Backsliders) to the more representative RP3 estimates of the total number of private renter households in stress (465,000) and applying the RP9 estimate of 10 per cent of purchaser households (described as Stretched) to the more representative RP3 estimates of the total number of purchasers in housing stress (265,000) to give a total of 212,000 households with severe housing affordability problems.

The estimates of households in housing stress who are coping (but at risk of having affordability problems) employs the same approach for the 30 per cent of stressed renters described as Aspirant purchasers and the 20 per cent of stressed purchasers described as Ambivalent to give 192,500 households.

The remaining 404,500 households are described as having some but not severe affordability problems as a result of their housing stress.

These estimates can be compared with competing alternatives described below.

(1) RP3, Table 1.1 (2002-03 SIH data) reports 417,000 households in housing crisis (50/40 rule) (that is paying 50 per cent or more of their income on housing). If the 172,000 single person households below 65 years old are excluded, this leaves 245,000, which is higher, but comparable with the data reported in Figure 3.4.

(2) RP6, Table 3.2 (2003-04 SIHC/HES data) reports 272,000 households in housing stress (30/40 rule) who also experience high levels of financial stress and 216,000 households in housing stress who experience no financial stress (and therefore might be described as coping). The first of these is somewhat higher than the number with severe housing affordability problems reported in Figure 3.4. The latter is comparable with the estimate of those coping but at risk reported in Figure 3.4.

In other words, the estimates presented in Figure 3.4 are relatively conservative when compared with competing alternatives from a number of sources and using a range of measures to define households experiencing housing affordability problems. All of the estimates reported here exclude the 164,000 moderate income households in housing stress who also experience housing affordability problems, often as a result of the costs of home purchase. They also exclude the 100,000 persons estimated to be homeless.

¹ Definitions of housing stress in this report exclude the estimated 100,000 or more persons who are homeless (AIHW, 2005, p 318). While estimates of the numbers and composition of those in housing stress will differ depending on the precise measure employed, it makes little difference whether housing costs are defined in relation to gross or disposable income and whether the lowest two quintiles are based on gross or disposable income adjusted or unadjusted for household composition (that is, equivalised) when this indicator is used to indicate the broad scale of the housing affordability problem and trends in this over time (RP3). In this report, lower-income households are defined as those with household incomes that place them in the lowest two quintiles of the equivalised income distribution. Equivalised disposable income is derived by dividing disposable income by an equivalence factor using the 'modified OECD' equivalence scale in which the first adult in the household has a weight of 1 point, each additional person aged 15 year or more has a weight of 0.5 points and each child under the age of 15 a weight of 0.3 points. The purpose of this adjustment is to allow for the economies of scale that arise from the sharing of income. In 2002-03, households with an equivalised disposable household income of less than \$367 per week were defined as lower-income households. This covered:

- a single person with a gross income around \$25,000 per annum
- a sole parent with one child with a gross income around \$32,000 per annum
- a couple with one earner and no children with a gross income around \$35,000 per annum; and
- a couple with one earner and two children with a gross income around \$55,000 per annum.

² Descriptions of the characteristics of households defined by the typology used here are provided in Chapter 3 of this report.

³ There are no reliable time series data on household income per household, in part because of changing definitions of, and the lack of reliable data on, the number of households in Australia prior to 1986. Estimates used here are taken from National Accounts data (corrected for income for that derived by unincorporated businesses) and converted to a per household basis from estimates of numbers of households derived from adjusting census data by official estimates. Household Survey estimates of average household income are consistently below those generated from National Accounts data.

⁴ Australian Government (2007).

⁵ These estimates of affordability constraints, based on Australia-wide medians for first home buyers, hide significant variations between regions. ABS data on established house transfers for June 2006 suggest the Australia-wide capital city median was \$380,000 and varied from \$265,000 in Hobart to \$495,000 in Sydney (ABS Cat. No. 6416.0, Table 7). Medians for first home buyers are lower than those for all transfers, but spatial variability in the data provides a clear indication of the greater difficulties faced by would be purchasers in high-cost regions.

⁶ Data from ABS surveys show average real rents paid (that is, after the effect of inflation is removed) increased from \$189 per week in 1994-95 (in \$2006) to \$211 per week in 2003-04 (in \$2006) (ABS Cat No. 4130.0.55.001 Housing Occupancy and Costs, Australia, 2003-04, Table 1, with CPI adjustment). Applying the same approach to average private rents paid in 1984 (ABS Cat. No. 6531.0, Table 29), gives an increase from \$157 per week in 1984 (\$2006) and an annual rate of increase over the period of 1.56 per cent per annum. Index data on rents as recorded in the CPI can be found in ABS Cat. No. 6401.0, Table 7.

⁷ Evidence of trends in the rental stock and displacement of lower income households can be found in Yates and Wulff (2000, 2005). Evidence of location of low rent stock in Melbourne can be found in Wood (2005) and in Sydney in Yates and Reynolds (2003). Changes in the location of low-rent stock provide one example of trends not reflected in CPI rent data. Preliminary analysis of 2006 census data suggest the trend towards loss of low-rent stock has continued.

⁸ The Productivity Commission Report on First Home Ownership (2004) provides a comprehensive and accessible overview of factors affecting housing markets in Australia.

⁹ Burke and Zakharov (2005) provide a more comprehensive overview of the potential risks for housing associated with demographic, economic and other trends than is covered indicatively in the text in this report.

¹⁰ Detailed results in this report are derived from the confidentialised unit record files from the 2002-03 Survey of Income and Housing (ABS Cat. No. 6541.0). Data from the 2003-04 survey (ABS Cat. No. 6540.0.00.001) have since become available. The overall picture is broadly similar to that reported here. The delays in the availability of such data highlight the difficulty in obtaining timely results. Early results from the 2006 census provide evidence consistent with the results obtained from NRV3 research (e.g. "One million squeezed on home costs", *The Age*, 11 July 2007).

¹¹ These categories are overlapping, so that a single person less than 65 years old and renting privately is counted in all three groups. Duration estimates, and details of those in housing stress can be found in RP3 along with estimates of the numbers involved and the incidence of stress among different household types.

¹² Comparable data are not available for earlier periods.

¹³ The base estimate was derived from NATSEM's STINMOD using assumptions about future demographic, economic and housing trends which, as far as they are covered in the IGRs, are consistent with those reports. Demographic assumptions about numbers and types of households were derived from ABS data to 2025 and from Productivity Commission data (which build on the ABS data) from 2025 to 2045. Housing costs for all households were assumed to increase in line with household incomes and tenure outcomes were based on using a cohort approach to project forward age-specific data for 2001 on the assumption that there is no further deterioration in access to home ownership in the future than has already occurred. More details can be found in RP11. The estimate reported here is 30 per cent higher than the 1.2 million in stress in 2045 produced by NATSEM. The version of STINMOD employed was based on up-rating of SIHC data for 2000-01 and 2002-03. Even after allowance was made for the higher number of households in 2006 compared with 2002-03, the base estimate of those in stress in 2006 was estimated to be 640,000, 30 per cent less than the estimate of 860,000 from the raw ABS survey for the same period. Explanations for these differences are given in RP11.

¹⁴ The relationship of the typology outlined here to those employed by other authors (specifically, Varady and Lipman, 1994; Dieleman et al, 1995; Wulff, 1997; Goodman, 1999; Gans and King, 2003; and Genworth, 2006) are provided in RP9.

¹⁵ Realistically, many moderate-income households could also be included in the estimates of the numbers of Stretched purchasers. Inclusion of all moderate-income purchasers paying at least 30 per cent of their income on housing would double the estimate of Stretched purchasers.

¹⁶ The estimates of numbers involved have been derived by applying the RP9 proportions to the national numbers of renter or purchaser households in stress reported in RP3. This provides a lower bound because the survey did not focus entirely on lower-income households. Thus the proportions of those surveyed as strugglers etc, have been generated from a total that includes higher- as well as lower-income households and underestimate the proportions that would apply if only lower-income households had been surveyed. Upper bound estimates can be obtained by applying the RP9 proportions to the total number of households in Australia with high housing cost ratios.

¹⁷ Precise details about derivation of these Figure 3.4 estimates are provided in the information on sources for tables, figures.

¹⁸ See Bridge et al (2003).

¹⁹ Perri 6 (1998, p 358).

²⁰ Productivity Commission (2004).

²¹ See Bridge et al (2007) on the implications of housing tenure for the costs of aged care.

²² Support for these claims can be found in Kelly (1992) and Wulff (1993).

²³ For example, Ford and Wilcox (1998).

²⁴ Gurran (2007, pp. 169-189)

²⁵ Productivity Commission (2004).

²⁶ These projections use Treasury economic and demographic forecasts and assume that housing policy settings remain unchanged (RP11).

²⁷ See Beer et al (2006).

²⁸ Berry (2003); Lawson and Milligan (2007).

²⁹ See, especially, Affordable Housing National Research Consortium (AHNRC)(2001), Allen Consulting (2004), National Affordable Housing Summit (NAHS)(2007).

³⁰ This idea is similar in concept to the two-tier rent subsidy system proposed by Burke (2005).

³¹ Lawson and Milligan (2007).

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